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HAROLD B. WILLEY, Clerk

In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 441

346 U.S.
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WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. duP. BAYARD, RECEIVER,
Petitioners,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD.,
Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

(Following action taken below after remand by this Court in No. 150, Oct. Term 1952, together with appendices containing copy of petition for writ of certiorari in said No. 150 and opinions below after the remand.)

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No .....

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vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD.,
Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Western Pacific Railroad Corporation and Alexis I. duP. Bayard, its Receiver, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit. Certiorari was granted to review this same judgment in No. 150, October Term 1952.[1] The case was then briefed and argued on the merits. In April, 1953, this Court remanded it for further proceedings, as hereinafter stated more fully.

[1]The record now before this Court is the same record as was before it in No. 150, Oct. Term 1952, plus an additional volume (Vol. VII) containing this Court's mandate and the subsequent proceedings and opinions below. For convenience those subsequent opinions are printed as Appendix II to this petition.

OPINIONS

The opinion of the District Court (R. 258) is reported in 85 F. Supp. 868. Several opinions in the Court of Appeals (R. 2214, 2239, 2260, 2288, 2296) are reported in 197 F.2d 994. The opinion of this Court is reported in 345 U.S. 247. Subsequent opinions in the Court of Appeals (R. 2354, 2356, 2359) are reported in 205 F.2d 374. A still later opinion below (R. 2363) is not yet in the Federal Reporter but appears in CCH Federal Tax Reporter, ¶ 9543, p. 48, 455.

JURISDICTION

The District Court had jurisdiction under 28 U.S.C., Sec. 1331, 1332, and the Court of Appeals under 28 U.S.C., Sec. 1291 and 1294(1). That Court's judgment was entered October 29, 1951 (R. 2255). Later it denied a timely petition for rehearing, struck a timely petition for rehearing en banc, and denied leave to reinstate the latter (R. 2257-60, 2287). Thereafter, this Court granted certiorari, vacated the orders denying rehearing and leave to reinstate the petition for rehearing en banc, and remanded the cause (R. 2321; 345 U.S. 247). On August 20, 1953, the court below again denied the petition for rehearing and denied the petition for rehearing en banc (R. 2362).

QUESTIONS PRESENTED

1. A. Must a former parent corporation join in consolidated federal income and excess profits tax returns with its former subsidiary, so that a loss incurred by the former parent may be used to extinguish the tax liability of its former subsidiary, without any accounting by the former subsidiary to the former parent for the benefit thus obtained? The loss so utilized was the parent's loss of its entire investment in the subsidiary (I.R.C., Sec. 23(g)(2) and (4)).

B. Is this required as a matter of construction of the federal tax statutes and regulations? Do the statutes and regulations require that the benefit of a tax use of a loss must go to one who

did not suffer the loss and preclude it from being used to ameliorate the loss of the party who did?

C. In asking this Court to affirm a railroad reorganization plan which destroyed petitioner's ownership of respondent and gave that ownership to respondent's creditors completely, the creditors urged that respondent's great current income was no support for a continuing ownership interest in petitioner because the huge wartime taxes would largely consume that income. This Court so held in affirming the plan, in *Ecker v. Western Pacific Railroad Corporation,* 318 U.S. 448. The creditors thereafter used the very loss inflicted on petitioner by this Court's decision to avoid paying those very taxes which were a predicate of that decision. Was that not such a misuse of this Court's decision as to make retention of the enrichment of the tax savings unjust to petitioner, is not a denial to petitioner of any equity in the tax savings so achieved by use of its loss erroneous, and do the tax statutes and regulations preclude recognition of any such right in petitioner?

2. Is determination of what fair arm's length bargaining would have yielded, in a case where that issue is relevant, beyond the constitutional scope of federal judicial power?

3. Are claims barred because of non-presentation in railroad bankruptcy (Sec. 77) proceedings, when they arose after revesting of the properties in the reorganized debtor or where, as a condition of revesting, the latter assumed all liabilities of the trustees?

4. Does not a Court of Appeals exceed its appellate office and so far depart from the accepted and usual course of judicial proceedings as to call for this Court's power of supervision [Supreme Court Rule 38(5)(b)], where it finds facts *ab initio* to affirm a judgment which it holds to be non-sustainable on either the legal theories applied or the facts found by the trial court, particularly where its findings are contrary to those which the trial court made clear it would have found had it considered the issues material?

5. Has the court below obeyed this Court's mandate in No. 150, Oct. Term, 1952?

STATUTES INVOLVED

The pertinent provisions of Internal Revenue Code, Sec. 23(g)(2) and (4), 52, and 141, Treasury Regulation 104, R.C.P. 52(a), and Bankruptcy Act, Sec. 77 (11 U.S.C., Sec. 205) are printed in Appendix I hereto.

STATEMENT

This case was before the Court, after grant of certiorari, as No. 150, October Term, 1952. The pertinent facts appear in our Petition for Certiorari there[2] and, in part, in the subsequent opinions in *Western P. R. Corp., et al. v. Western P. R. Co., et al.*, 345 U.S. 247 (April 6, 1953). Briefly, as stated in the opinion of the Court (345 U.S. at 249):

> "The petitioners[3] in these causes—a corporation and some of its stockholders—seek an accounting from respondents—certain other corporations which, prior to a reorganization in 1943, were subsidiaries of the petitioning corporation. It is petitioners' theory that respondents had unjustly enriched themselves by wrongfully appropriating a 'tax loss' incurred by petitioner Western Pacific Railroad Corporation and applying it to the sole benefit of respondent Western Pacific Railroad Company."

Petitioner Corporation (hereafter called petitioner) had owned all the capital stock of respondent Western Pacific Railroad Company (hereafter called respondent) for which it had paid $75 million (R. 262). In 1935 respondent went into bankruptcy, and trustees were appointed, remaining in possession until December 29, 1944 (R. 1908, 1916). The plan of reorganization proposed for respondent by the I.C.C. and sustained by this Court on March 15, 1943 in *Ecker v. Western Pacific Railroad Corp.*, 318 U.S. 448, excluded petitioner from participation in the reorganization and wiped out its $75 million investment.

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[2]A copy of the bulk of that petition is atached hereto as Appendix III.

[3]The petitioners referred to were those in No. 150, who are the petitioners here, and in No. 160, a companion case.

Under the Internal Revenue Code, Sec. 141, a parent company and its subsidiaries may file consolidated returns in which losses of all are offset against the gains of all. I.R.C., Section 23(g)(4), as amended in October 1942, provided for the first time that a loss arising from worthlessness of stock in a subsidiary is an ordinary rather than a capital loss and thus deductible from taxable income. Thereby petitioner's loss, resulting from this Court's decision in the *Ecker* case, became available as an offset against income.

Consolidated returns for 1943 and 1944 and a claim for refund of the 1942 tax were filed, using this loss of petitioner's to offset respondent's income. In 1947 a settlement was made with the Commissioner of Internal Revenue (R. 262). Except for the offset of petitioner's stock loss, respondent would have had to pay an additional $17,201,739 in income and excess profits taxes (R. 2217-8). Thus respondent discharged a tax liability to the government of over $17 million by using petitioner's tax rights.

This remarkable result was, in the words of respondent's tax counsel, "paradoxical" (R. 265), because the loss used to save respondent taxes was the loss sustained by petitioner in losing ownership of respondent, whereby petitioner lost any further economic interest in respondent and could not, as a stockholder, gain any benefit from the discharge of respondent's taxes.

THE RESULT WAS OBTAINED BY RESPONDENT'S TAKING OVER PETITIONER'S AFFAIRS AND DIRECTING ITS ACTIONS.

This result was accomplished by respondent's taking over and managing petitioner's affairs for respondent's own benefit, without regard for the rights of petitioner or petitioner's stockholders. It was able to do these things because it controlled Curry, petitioner's titular president.

As the trial court found, respondent through its tax counsel conceived the idea of using petitioner's loss (R. 261), decided to put the idea into effect (R. 265, 266), prepared all the operative documents and settled the subsequent tax controversy with the

government (R. 262, 263, 470, 1442). Curry signed the documents in petitioner's name. Though he was its president, he received no compensation from it; he had become president, succeeding his predecessor, whose chief clerk he had been, because of its impoverishment (R. 645, 743). Concurrently he was an employee of respondent, either in its office or in the office of its counsel (P. Ex. 2A). He received his entire livelihood from it (R. 530, 532, 1729-33, 1744, 1749). He had no understanding of tax matters, which "were wholly Greek to me" (R. 808), and was described by the trial court who had heard him testify as "just a presiding officer and a sort of figurehead," a description he admitted (R. 646-647). In what he did in the premises he took his orders from respondent's tax counsel, who considered that they were responsible to it alone (R. 1431).

The operative documents were never submitted to petitioner's Board of Directors for consideration or approval (R. 261). Most of the Board consisted of employees, even mere clerks, of respondent, receiving their livelihood from it (R. 1135-1139).[4] Only two had the capacity or financial independence to give competent disinterested attention to petitioner's affairs in any matter in which respondent could have an adverse interest. But not until shortly before the present suit was filed did they learn that petitioner's tax loss had been used in the tax returns and that thereby respondent was discharging its liability for federal taxes (R. 1019, 1022, 1024, 1129, 1132).[5]

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[4]During the material period, nine persons were at one time or another directors of petitioner. One was respondent's switchboard operator, one its stenographer and clerk, and one its clerk, put on petitioner's board to constitute a quorum (R. 1138, 1139). They received no pay from petitioner, nor did three others, also respondent's employees, one of them a director and chairman of respondent's executive committee and one of its trustees in bankruptcy (P. Ex. 2A). Another was a clerk in the latter's employ in another company (R. 1135).

[5]While both (Wood and Osborn) supposed that consolidated returns were being filed, they did not know that petitioner's loss was being used or even that it could be. The right so to use it was first made possible by statute in October 1942. The idea of using the loss to save respondent taxes did not even occur to respondent's tax counsel until May 1943 and then he stated it to be a mere speculation of a possibility, "commented on rather than

PROCEEDINGS BELOW PRIOR TO GRANT OF CERTIORARI BY THIS COURT.

The District Court gave judgment for respondent. By a panel consisting of one circuit and two district judges, the court below affirmed (R. 2214), denied a petition for rehearing and struck a petition for rehearing en banc as unauthorized in law (R. 2260). One judge (Fee, J.) dissented (R. 2239) and requested a rehearing en banc (R. 2261). Subsequently, on July 9, 1952, the court en banc denied a motion for leave to reinstate the petition for rehearing en banc, on the ground, among others, of lack of power to grant such a rehearing without the approval of the panel (R. 2288; 197 F.2d 1013).

GRANT OF CERTIORARI AND DECISION OF THIS COURT.

Certiorari was then sought on the merits, as well as on the en banc question, and was granted without limitation as to issues (344 U.S. 809, and 345 U.S. 247 at 250). The case was thereupon briefed and argued here on the merits. Concluding that the en banc issue warranted a remand, the Court's final decision did not reach the merits.[6] On April 6, 1953, this Court vacated the orders by which the court below had denied a rehearing and leave to file a motion to reinstate the petition for rehearing en banc, and it remanded the case for further consideration of the application for a rehearing en banc after adoption of a procedure for dealing with such matters (R. 2321).

PROCEEDINGS BELOW AFTER THIS COURT'S MANDATE.

May 27, 1953, the court below adopted such a procedure by an addition to its Rule 23 (R. 2353). The new rule recast into terms of practice what the court had stated as a limitation of power in

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suggested * * * since it is paradoxical." (R. 588, 591.) Not until December 1943 did respondent's tax counsel decide that it could be done, and he then advised respondent but not petitioner (R. 1448, 1484). He sent a written opinion on the subject to respondent but sent no copy to petitioner (R. 605, 613, 614, 665).

[6]Mr. Justice Jackson stated that he would reverse on the merits, which he discussed in a separate opinion.

its opinion of July 9, 1952.[7] The rule restored command of the matter of granting a rehearing en banc, in any case, to the division that had heard the cause, and made the panel's willingness to rehear the case a condition precedent to a rehearing en banc.

June 12, 1953, the court below entered an order en banc referring this case back to the division for action under the new rule (R. 2354).[8]

Chief Judge Denman, describing the order as one "in which the Court of Appeals en banc divests itself of its jurisdiction of this

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[7] *Opinion of July 9, 1952 (R. 2294; 197 F.2d at 1015):*

"circuit judges may not intrude themselves * * * upon a court or division on which they have not by order of the court been directed to sit.

"A petition for rehearing in any such case, whatever its form or wording, must necessarily be treated as addressed to and is solely for disposition by the court or division to which the case was assigned for determination. If the court so constituted, or a majority of its members, denies the petition, that ends the matter so far as concerns the Court of Appeals. If it grants a rehearing, it may follow either of two courses: (a) it may, and in all ordinary situations does, rehear the case itself; or (b) it may for reasons thought adequate suggest to the nonparticipating judges that the case is one which ought to be reheard in banc; and if all or a majority of the circuit judges agree, the case is then placed on the calendar for in banc consideration."

Amendment to Rule 23 (R. 2353):

"All petitions for rehearing shall be addressed to and be determined by the court as constituted in the original hearing.

"Should a majority of the court as so constituted grant a rehearing and either from a suggestion of a party or upon its own motion be of the opinion that the case should be reheard en banc, they shall so inform the Chief Judge. The Chief Judge shall thereupon convene the active judges of the court and the court shall thereupon determine whether the case shall be reheard en banc."

[8] The order read:

"Pursuant to the Supreme Court's decision of April 6, 1953, and this court's Rule 23, as amended, it is now hereby ordered by this court en banc that the petition of March 10, 1952, be and is hereby referred back to the division, and that the division be and is hereby designated and assigned to consider that petition and to take such action thereon as may be proper, such action to be in conformity with this court's Rule 23, as amended."

appeal," later filed a separate opinion (R. 2359) in order to note that the question of a rehearing en banc had never been really considered before, to make clear that it was to be considered *de novo* by the division, and to list a number of factors that the division ought to take into consideration, namely:

> "(a) That the case is described by the Supreme Court as 'difficult and complicated litigation,' p. 19 slip opinion, and that it is 'as complicated as it is unique,' p. 1.
>
> "(b) That the amount involved in the case is stupendous, being $21,000,000, and that the issues are very intricate such as might invoke the pooled wisdom of all the circuit judges as stated in the opinion of Mr. Justice Frankfurter at page 4.
>
> "(c) That the Supreme Court deems this case so important that it granted certiorari on the merits as well as on the question of rehearings en banc."

Judge Pope dissented from the order of June 12th (R. 2356), stating that the order "means that if the division is of the same opinion it was before then the case is at an end." Since the new rule was not in effect when the pending petitions were filed, he believed that

> "To apply such procedure retrospectively in the circumstances of this case would * * * be an abdication of the duty which this court owes to these litigants.
>
> "* * * it is the duty of this court, as now constituted, to spare no effort to bring this important litigation to a right conclusion. We have here a case involving an apparently novel point of law. To date the judges who have considered its merits are equally divided as to who should win. Mr. Justice Jackson and Judge Fee think the plaintiff should prevail. Judge Healy and Judge Byrne think otherwise. There remain six judges of this court whose power to break this tie is clear. The question is, is it our duty to do so? I think it is. I cannot think of a situation more clearly requiring action rather than abstention, decision rather than avoidance. The case is now in our hands as a full court. I think it is our duty to keep it there, to hear arguments on it, and to decide it."

By reason of the order of June 12th, "the original petitions for rehearing and rehearing en banc [came] again before [the division] for disposition" (R. 2364).

August 20, 1953, both petitions were denied (R. 2362). However, "Judge Fee did not participate in this determination" (R. 2362, 2373). Judge Fee was the member of the division who had dissented from the original decision. Thus a two judge panel, without the cross-fertilization of judgments that could come from participation of even a third judge, precluded further consideration by the court of the desirability of a rehearing en banc. The "function under [28 U.S.C.] Section 46(c) [was] discharged definitively" by two judges, the very two "whose judgment may call for *en banc* action."[9]

The order of August 20th denying a rehearing and preventing a rehearing en banc was accompanied by an opinion (per Healy, J.) (R. 2363). It falls into two sections, one addressed, in effect, to the opinion herein of Mr. Justice Frankfurter, and the other explicitly addressed to the opinion of Mr. Justice Jackson.

THE FIRST SECTION OF THE OPINION OF AUGUST 20TH.

As a succinct statement of factors relevant to the issue of whether a rehearing en banc was appropriate, the following passage from Mr. Justice Frankfurter's opinion (345 U.S. at 270) had been called to the court's attention by us (R. 2333) and to the panel's attention by Chief Judge Denman (R. 2361):

> "determinations *en banc* are indicated whenever it seems likely that a majority of all the active judges would reach a different result than the panel assigned to hear the case or which has heard it. Hearings *en banc* may be a resort also in cases extraordinary in scale—either because the amount involved is stupendous or because the issues are intricate enough to invoke the pooled wisdom of the circuit."

The opinion of August 20th does not mention the question whether a majority of all the active judges might reach a different

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[9]This is a paraphrase of a passage in Mr. Justice Frankfurter's opinion in *Western P. Corp. v. Western P. Co.*, 345 U.S. 247 at 272.

result from the panel.[10] As for the other factors, the opinion does not deny their presence. It simply denies their relevance to the granting of a rehearing en banc, in any case.[11] Nor is there any mention of the fact that the legal questions on the merits in this case have been described by several judges during the course of the appeal as "serious and important" "affecting the fields of bankruptcy and taxes,"[12] "important litigation,"[13] "interesting questions" involving "federal bankruptcy proceedings and federal tax rulings,"[14] "intricate,"[15] or of the fact that they have been deemed of such interest to the law as to be the subject of two law

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[10]Only one judge on the panel was eligible to sit en banc, the others being district judges. On August 20th there were but six judges eligible to sit en banc, there then being but 6 active circuit judges, Judge Mathews having resigned (28 U.S.C. Sec. 46c). Only three of the six had expressed any views, and of these three Chief Judge Denman and Judge Pope had indicated that the merits were not a closed matter. Thus, of six judges who have made any statement on this subject during the appeal, 2 have stated that petitioner should prevail on the merits, 2 have indicated that it might, and 2 that it should not. Yet the latter 2 have foreclosed consideration by the 6 active circuit judges.

[11]It states that rehearings en banc will be granted only in case of an intra-circuit conflict or where the public has an interest (R. 2364), without stating any test of the latter. As examples of public interest it cites (R. 2364, fn. 4) two cases, which the opinion of July 9, 1952 (by the same judge) had described as "nondescript matters" (R. 2294, fn. 6).

The opinion of August 20, 1953 further states (R. 2366) that "unless the gates are to be opened to a flood of horizontal reviews it seems essential that we adhere to the principles which have guided us in the past." The opinion of July 9, 1952 had said (R. 2292, fn. 4), "There are no definite criteria that we know of by which to determine what cases are suitable for in banc consideration."

Cf. Judge Maris, "Hearing and Rehearing Cases in Banc," 14 F.R.D. 91. Noting this Court's decision herein, 345 U.S. 247, he says, "the fears of the Court of Appeals of the Ninth Circuit expressed in the Western Pacific Railroad Corporation case, 197 F.2d 994, 1015-1016 that the procedure would be burdensome and crippling to the administration of the court have not been borne out by the experience of the Third Circuit." (p. 96)

[12]Judge Fee, R. 2261.

[13]Judge Pope, R. 2357.

[14]Mr. Justice Jackson, 345 U.S. at 275, 276.

[15]Chief Judge Denman, R. 2361.

review articles,[16] and that the rights of more than 4700 people on petitioner's side are at stake (R. 659).

SECOND SECTION OF THE OPINION OF AUGUST 20TH.

The second section of the opinion of August 20th is addressed to Mr. Justice Jackson's opinion herein (345 U.S. 273) and is prefaced by the statement, "Our respect for the pronouncements of the Justice will not permit us to leave his comments unnoticed" (R. 2367). It endeavors to show error in Mr. Justice Jackson's reasoning and conclusion that petitioner is entitled to prevail on the merits. In the course of the effort and as buttresses for its original decision, the court seizes upon grounds and uses reasoning not relied on, or even mentioned, by it in that decision, and therefore not argued in the petition for rehearing. The opinion of August 20th is thus another opinion on the merits and would seem to have been more appropriate to a decision rendered after a rehearing had been granted than to an order denying rehearing. Such an order completely precluded argument of the new matter, and thereby, we feel, precluded the adequate consideration the case warrants, particularly since it discusses and sharply rejects Mr. Justice Jackson's views and reasoning, expressed after the original decision which the court declined to rehear, without giving petitioner an opportunity to be heard in respect of those views.

REASONS FOR GRANTING A WRIT

This Court knows best whether the court below has obeyed its mandate in No. 150, Oct. Term, 1952; on that question, we shall add nothing to the Statement of what occurred after the remand [But cf. views of Clark and Frank, Ct. JJ., in *In re Sacher*, 206 F.2d 358, 366 (2 Cir., Aug. 20, 1953)].

In the following pages we pray that the Court review the case on the merits.

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[16]38 Cal. Law Rev. 946; 65 Harvard Law Review 1256. The article in 5 Stanford Law Review 332, cited in Mr. Justice Jackson's opinion, is confined to the en banc question.

The opinion denying rehearing after that remand reasserts the views that gave rise to the questions on the merits presented in our Petition for Certiorari in No. 150, Oct. Term, 1952. The grant of certiorari there included those questions. Since the Court's subsequent decision did not reach the merits, being rested on the *en banc* issue, these questions are now re-presented as Questions 1A and 4. The latest opinion below also endeavors to support the decision by additional reasoning which not only sharpens those questions and makes the necessity to review them more acute but gives rise to further important questions.

Since reasons for reviewing the merits were stated in our petition in No. 150 and the case was thereafter fully briefed and orally argued in this Court in December 1952, we attach a copy of that petition as Appendix III, summarize its substance, and note the bearing of the new reasoning below.

This case involves the legal consequences attaching to the filing of consolidated tax returns under federal tax laws, the construction of federal tax statutes, the consequences of railroad reorganization under federal bankruptcy laws, the proper delimitation of the appellate office as respects the fact finding function, and a novel limitation of federal judicial power. Proper accounting between the innumerable corporations filing consolidated returns depends on a correct decision. The decision below is in conflict with decisions of other circuits and with applicable decisions of this Court, and it is diametrically opposed to the views of a Justice of this Court in this case on an important issue of statutory construction and in an important field of law. Unless the issue is settled authoritatively, it will breed complex litigation in ever-widening circles.

I.

The Decision Rests on a Novel Rule of Law Affecting Taxes and Corporate Reorganization and a Novel Construction of the Federal Tax Laws Concerning Consolidated Returns.

The essential ground of the decision is its announcement of a new principle of law, viz: That wherever the tax laws permit two corporations to join in consolidated federal tax returns, and one

has a loss and the other has income, the former must join with the latter and permit its loss to be used for the latter's benefit, and without payment, consideration or compensation.

And since, "when the returns and the claim for refund were filed, affiliation no longer existed" (R. 2230-1), the principle as applied went further, namely: A former parent is under a duty to join in a consolidated return and permit its loss to be used to satisfy a former subsidiary's tax, without compensation, even though it has no economic interest in the latter and can derive no benefit therefrom.

This is tantamount to holding that the income corporation can sue in equity for a mandatory injunction to compel the loss corporation to join and confer the benefit of its loss, gratis.

As shown in our petition in No. 150, October Term 1952[17], this basic holding is inconsistent with the rationale of consolidated returns and the purpose of Congress in allowing them, it makes mandatory what Congress left optional, and it thereby conflicts with decisions of the Second Circuit and the Fourth Circuit.

The true rule, we submit, is that expressed by Mr. Justice Jackson when this case was last here (*Western P. R. Corp. v. Western P. R. Co.*, 345 U.S. 247, 277):

> "Congress has authorized, but has not required, that these two be merged by means of a consolidated tax return. Each has the right, but no legal duty, under federal law to join in consolidated returns.
>
> * * * * * * *
>
> "Each of these corporations had something to contribute to a tax saving plan. Either alone was helpless. But I know of no moral or legal obligation to give away any legal opportunity or advantage just because its owner cannot utilize it himself.
>
> "There would have been nothing remotely illegal or improper if the management of the plaintiff corporation had demanded some compensation for its loss privileges. Indeed, it is probable that the intention of the statute permitting the consolidation of the two positions was to provide salvage for the loser, not profit for one which sustained no loss."

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[17]Pp. 3 to 13, Appendix III hereto.

THE LAST OPINION BELOW GOES TO A FURTHER EXTREME BY STATING ITS NOVEL RULE AS A MATTER OF CONSTRUCTION OF FEDERAL TAX STATUTES.

The last opinion below rejects Mr. Justice Jackson's observations and reasserts the basic views of the decision of October 1951 thus (R. 2369):

> "In our decision we discussed the obligations of a holding company to its subsidiary and creditors, and its duty not to attempt to appropriate to itself an advantage *which the tax laws give the subsidiary.*"

Bolstering its decision by new reasons, the court first prefaces them with the statement that it does so "without intending to detract from the soundness of that principle" (R. 2369), and then, in the very course of stating its new reasons, carries its basic holding further. The decision of October 1951 had not made clear whether the supposed duty on petitioner's part to give the tax utility of its loss to respondent was based on a construction of the tax statutes or extracted from some notion of equity. But the latest opinion rests the duty *on a construction and interpretation of the federal tax laws,* for, as noted, it speaks of the "advantage" as one "which the tax laws give the subsidiary," and further states (R. 2371):

> "They [appellant] did not threaten to repudiate the established practice of past years and deny to the creditors *an advantage that the tax laws gave them,* nor did they demand tribute for their cooperation. With full knowledge of all the facts surrounding the transaction appellant chose to follow the custom of previous years and *permitted the tax advantage to fall where the tax laws ordained.*"[18]

This is an outright holding that the tax statutes required petitioner to give the utility of its loss to respondent. It may be contrasted with Mr. Justice Jackson's view that

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[18]As for the statement in the quoted passage about appellant's alleged full knowledge, see pp. 5, 6, supra. The subject of "past practice" adverted to here and elsewhere in the opinion of August 20, 1953 is commented on in our petition for certiorari in No. 150, Oct. Term 1952 (pp. 20, 21 of Appendix III hereto), and our main brief in No. 150 at pp. 121-124.

> "it is probable that the intention of the statute permitting the consolidation of the two positions was to provide salvage to the loser, not profit for one which sustained no loss." (345 U.S. at 277)

The extreme to which the court has now gone finds illustration in a comparison of its reasoning with that of the District Court. Petitioner has contended, among other things, that the only way in which the tax statutes can make sense in permitting petitioner's loss to be used to offset another's income for tax purposes is either to recognize a purpose in Congress that the tax savings should go to the parent corporation who had suffered the loss, to ameliorate it, or else to recognize an equity in the parent to receive the savings as such an amelioration.[19]

The District Court believed that the Treasury ought not to have permitted the tax savings at all. It said (R. 270):

> "To assume * * * that the Congress intended * * * to statutorily authorize what was done in this case is to attribute plain stupidity to the Congress of the United States—an unthinkable procedure despite the general habit of criticism both fair and unfair."

and

> "If I had the power * * * I would order these taxes paid to the United States."

It characterized the tax savings as "amazing and undeserved" (R. 276). For that reason, strangely, it held for respondent. As Judge Fee described this holding, because the trial court believed "that the 'tax escape' was a fraud upon the government" it gave the proceeds to the "wrongdoer" (R. 2239-40). The consequence was that the revenue laws were made absurd, an inadmissible result under rules of statutory interpretation often stated by this Court.[20]

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[19]See pp. 42, 43 of our brief, filed in this Court herein in No. 150, Oct. Term 1952, after certiorari was granted.

[20]Many of the decisions are collected by Judge Learned Hand in *Cabell v. Markham*, 148 F.2d 737 (2 Cir.). A Congressional purpose as to who should have the tax savings, apparent from its enactment, should be given effect. Cf. *United States v. Hutcheson*, 312 U.S. 219, 235; *Van Beeck v. Sabine Towing Company*, 300 U.S. 342 at 351.

Denouncing the trial court's reasoning in strong terms,[21] the court now holds that the tax laws not only tolerate this strange result but command it; it holds that the tax laws not only do not require the benefit of the use of a loss to go to alleviate the burden of the loss but also that they will not even permit that alleviation.

THE CONSTRUCTION BY THE COURT BELOW OF THE TAX STATUTES PRECLUDES RECOGNITION OF THE EQUITIES, ALL OF WHICH ARE WITH PETITIONER, INCLUDING THE FACT THAT THE USE OF THIS COURT'S DECISION IN THE ECKER CASE TO AVOID TAXES PRODUCED A RESULT CONTRARY TO AN ASSUMPTION ON WHICH THE ECKER DECISION WAS RENDERED, MAKING THE RESULTING ENRICHMENT UNJUST.

Respondent has been enriched by the use of petitioner's rights. The retention of that enrichment is unjust

(1) because it is inconsistent with the rationale of consolidated returns and the purpose of Congress in allowing them; and

(2) because respondent was able to and did appropriate petitioner's rights by virtue of a fiduciary and dominating relationship toward petitioner. These reasons were fully discussed in the briefs filed herein when the case was last before the Court, and we shall not amplify them here. But the enrichment is unjust for still another reason which ought to be mentioned because it involves the use of this Court's own decision.

When the I.C.C.'s Plan of Reorganization for respondent was before this Court in *Ecker v. Western P. R. Co.*, 318 U.S. 448, the plan's opponents contended that the huge wartime earnings altered the factual predicate on which the proposed destruction of petitioner's ownership equity was based. The plan's supporters asked that "that issue * * * should be faced squarely by this

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[21]The opinion of August 20th states (R. 2368, fn. 7):

> "Lurking in the background of this case is a specious element which has no proper place in the decision, but which, when injected by innuendo, casts its shadow across the record. There is an insinuation that the creditors received a windfall of millions of dollars at the expense of the United States by reason of a loophole in the tax laws."

This element was more than one lurking in the background of the case; it was the very warp and woof of the District Court's decision, which the court below affirms.

Court," but urged that the argument took "no account * * * of the increasingly heavy Federal income and excess profits taxes necessarily resulting from the very facts which give rise to the increased revenues."[22]

This Court then, "in the interest of advancing the solution of as many problems in reorganization as possible * * * deliberated upon the effect to be given these unexpectedly large earnings," and, in upholding the plan, noted that the "effect of taxation is not wholly answered by deductions of tax estimates on the basis of present rates" (318 U.S. at 507, 508). In the Milwaukee Reorganization case, decided the same day,[23] a similar problem was discussed more fully, and the Court concluded that the "bulge of war earnings" furnished no standard, because, among other reasons, of "the great increase in taxes."

Thus respondent's creditors, in seeking to sustain a plan that gave them petitioner's ownership, minimized the war earnings on the ground that they would largely be consumed by taxes. Succeeding in inflicting upon petitioner its loss, the creditors *thereafter* conceived the idea of using that very loss to avoid the payment of those very taxes.

We submit that such a use of this Court's decision in the *Ecker* case is an additional reason why retention of the enrichment would be unjust, and that the decision below, by cutting off any recognition of equities flowing from this fact, calls for review by this Court.

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[22]Brief of Institutional Bondholders Committee, pp. 61, 62. The brief continued by pointing out that the full impact of taxes awaited passage of the 1942 Revenue Act. Under the tax rates contained in the bill then pending, "the Federal income tax payable with respect to [1942] earnings would be approximately $1,500,000" and would reduce to $2,600,000 "an apparent war boom figure of $4,108,290. * * * Even this figure is before deducting for any excess profits tax which may be imposed upon the reorganized Western Pacific at the current earnings level, depending upon tax legislation as finally enacted."

In fact, but for use of petitioner's tax credits the tax for 1942 would have been $4,201,821 and for 1943 and 1944 over $17 million.

[23]*Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & P. R. Co.*, 318 U.S. 523, 543.

It will be remembered that when the reorganization plan was proposed in 1939 and approved by the Bankruptcy Court in 1940 (R. 1666, 1673), and when the *Ecker* case came on this Court's docket, the use of petitioner's loss, which consummation of the plan would inflict, as an offset to anyone's ordinary income was not yet legally possible, the statute that later made it so being enacted in October 1942. It will be remembered, too, that at the time of the *Ecker* decision the idea of using petitioner's loss to offset respondent's income was not yet conceived (see p. 5, and fn. 5a p. 6, supra). Thus the reorganization plan did not provide that respondent or its creditors should have the use of petitioner's loss, gratis or otherwise. Moreover, as will be noted, it could not have done so if it would.

It will be further remembered that the plan denuded petitioner of every interest in respondent, doing so for the benefit of respondent's creditors. To them it gave petitioner's ownership, which cost petitioner $75 million, and additionally it wiped out petitioner's claims as a creditor amounting to $7½ million. No other creditor was so treated (P. Ex. 20A, pp. 11 and 19; P. Ex. 20C, pp. 10-12).[24] The pre-organization creditors thus were given every interest in respondent or claim against it that petitioner had prior to the consummation of the reorganization plan.

Thereby petitioner suffered its huge loss. The opinion of August 20th intimates that these creditors somehow had an equity entitling them also to seize for their benefit petitioner's loss so inflicted. Thus it asserts that petitioner (R. 2368)

> "is claiming moneys which were earned through the operation of railroad properties in a trust estate administered for the benefit of unpaid creditors of its former wholly-owned subsidiary."

and that (R. 2369):

> "The title to and possession of the railroad properties were in the reorganization trustees who administered the operating

[24]Except a wholly owned subsidiary of petitioner which had a claim of only $61,667. Petitioner and this one subsidiary were the only unsecured creditors, and only unsecured creditors were denied participation in the reorganization. (See *Ecker* decision, 318 U.S. at 455, 466.)

company under the supervision of the United States District Court for the benefit of the unpaid creditors."[25]

In limine, it may be said that this tacit assumption that the old creditors remained unpaid, after wholly supplanting petitioner as owner of respondent, is unwarranted in fact. Other than petitioner,[26] the creditors were secured creditors. They received a 100% equivalent on the basis of stock values assigned (see *Ecker* opinion, 318 U.S. at 455, 461, 481, 487), except one of the James Interests, and its claim was scaled down by less than $3½ million (R. 2022). No finding was sought or made in the District Court on any issue whether the former creditors were unpaid. That court thought the issue wholly immaterial and rejected evidence on the subject (R. 1581-1583). Yet the court below buttresses its decision by an assumption of fact not found by the trial court. As we shall show in Part IV, this is not the only example of that kind.[27]

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[25]The passage continues:

"These creditors had acquired their equities at a time when the operating company was wholly owned and controlled by the appellant."

The fact is that petitioner was controlled prior to respondent's bankruptcy by the James Interests, who owned 61% of its common stock and only 8.8% of its preferred stock. These were the controlling human agents. As the result of respondent's reorganization the James Interests became the controlling power in respondent (P. Ex. 1). The effect of a judgment for respondent will be that the James Interests or their successors, common stockholders in petitioner, will benefit from the tax utility of petitioner's loss in preference to petitioner's preferred stockholders.

[26]And the one small creditor mentioned in footnote 24.

[27]The extraordinary position enjoyed by those creditors is shown by a few figures.

The plan did not contemplate that the reorganized respondent would emerge from bankruptcy with any surplus at all. But it emerged with an unappropriated earned surplus of nearly $30 million. (P. Ex. 20D, p. 15) The capital structure fixed by the plan was devised by the I. C. C. so that the reorganized Company would be able to pay an annual dividend of $3.00 per share of common stock out of the income it could reasonably expect to earn (R. 2179 at 2190; also see *Ecker* decision, 318 U.S. at 506, 507). But in 1943 it earned $27.99 per share of common stock, after setting aside $7,100,000 as a reserve to pay the very taxes it later saved by using petitioner's loss, or $50.24 before setting aside the reserve, and in 1942 it earned $20.28 per share (R. 2179 at 2189). Were it thought to be material, it can

Apart from the facts, the court's assertion is unsound law. That a railroad has once been in reorganization cannot mean that it may take and use another's property rights, gratis. Through a reorganization creditors of a company may permissibly supplant the former shareholders as the owners, as they did here, because the weight of debt submerges the equity of ownership, but they have no right to appropriate still other property of the former shareholders, in order to pay their claims.

Suppose respondent had discharged its tax liabilities with cash taken from petitioner or with the proceeds of shares in some other company owned by petitioner and seized by respondent, say U. S. Steel stock. Certainly respondent would have to compensate petitioner. Yet it could be said, with as much verity as the court below has stated here, that the payment would come out of respondent's "earnings." But such a statement would be a mere play on words.

All this is so obvious that the court's reasoning must rest on other assumptions. It asumes that petitioner was under a duty to join in consolidated returns and use its loss for respondent's benefit, and that petitioner, in asking that the benefit of the tax savings be adjudged to belong to it, is seeking an equity or value for its former stock ownership. But these are false assumptions. The consummation of the plan of reorganization stripped petitioner of that ownership and every other interest, but left it with its loss. The tax utility of the loss, created by Act of Congress, belonged to petitioner, who had become an economic stranger to respondent. After this Court decided the *Ecker* case respondent then seized that tax utility for itself. The Plan of Reorganization

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be shown that in every year since 1943 and to date respondent has earned, after preferred participation, more than $3.00 per share of common, averaging $6.30, and will approach $9.00 in 1953. (20 Standard Listed Stock Reports, No. 201.)

During the trusteeship $30 millions of operating revenues were used for additions and betterments, and another $6 millions of operating revenues were used to replace old equipment (P. Ex. 20C, p. 9). The remaining income from the effective date of the plan until December 31, 1943 was sufficient to meet all bond interest and to make all required payments into the capital fund and sinking fund and still leave $20,658,938 (R. 1196).

not only did not even contemplate any such seizure, but it could not have so provided. *Callaway v. Benton*, 336 U.S. 132.

After the federal bankruptcy laws have wiped out a corporation's entire investment in a subsidiary, neither the bankruptcy laws nor the tax laws intend that it be further stripped of its sole remaining asset, to further fatten the subsidiary's quondam creditors. The old creditors took everything—the sinews and the flesh—and no equity entitled them to pick petitioner's bones as well. Yet this is precisely what the court below has held.

THE BASIC HOLDING PERMEATES THE LAST OPINION.

The basic assumption that petitioner was under a legal duty to give its tax loss to respondent underlies a variety of supposedly independent reasons in the last opinion. For example, it underlies the repeated use of derogatory phrases about petitioner's demanding "tribute" or "exacting payment as a price" of cooperation (R. 2369, 70, 71).[28] A concise answer to this lies in the words of Mr. Justice Jackson (345 U.S. at 277):

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[28]As another example, after stating that it did not retreat from its basic decision, the court proceeded to say that in order for petitioner to recover (R. 2370):

> "* * * we must further assume that * * * the right to claim a tax offset which springs from ownership of stock that is completely worthless is not destroyed when the right to use the loss is determined to have a value of millions of dollars for bartering purposes."

The fact that Congress allows deductions for loss compels that very assumption; any deductible loss is *per se* valuable by Congressional mandate. Yet in the quoted passage the court below intimates that if petitioner should receive anything for the use of its stock loss, the stock would thereby have value, there would be no total loss, and the loss could not be used as a deduction. But the stock and the loss were two different things. The destruction of the stock created the loss. The tax laws then gave a value to that loss for certain purposes. As stated by Mr. Justice Jackson (345 U.S. at 276), "But it is not the loss; it is the right to use the loss as an offset that is valuable." Self evidently the fact that the sustaining of a loss is ameliorated by a tax utility does not mean that the loss did not occur.

If recognition of value in the use of the loss for tax purposes means that there is no loss, not only would no loss resulting from total worthlessness ever have a tax utility, but the result would necessarily be the same whether the petitioner obtained the benefit or respondent retained it. The only way to uphold the tax deduction if respondent benefits while denouncing

"Each corporation then had a bargaining position. * * * each had an indispensable something that the other was without. * * * Each of these parties had but one key, and how can it be said that the holder of the other key had nothing worth bargaining for? * * *

"* * * On the face of it, the conclusion would seem warranted that the plaintiff is entitled to what fair arm's-length bargaining would probably have yielded. To ask this can hardly be stigmatized as capitalizing mere nuisance value. This is not the blackmailing transaction which offers to forego doing another injury if bought off. This merely seeks a share in the benefit which it transferred."

II.

Federal Judicial Power Is Not So Impotent as the Court Below Holds

Addressing itself to Mr. Justice Jackson's statement, just quoted, that "plaintiff is entitled to what fair arm's-length bargaining would probably have yielded," the last opinion below expostulates (R. 2372, 2373):

"How could the courts remake the contract for the parties?[29] How could this court or the district court determine 'what fair arm's length bargaining would probably have yielded'? Bargaining presupposes negotiations to determine the maximum amount a buyer is willing to pay and the minimum amount a seller is willing to accept. Such activity is a matter of business administration, and is not a judicial function. A district court, like the court of appeals, is a constitutional court and 'neither has any power or function other than what is strictly judicial.' "

This is a holding that, where one takes from another a thing of value, he is under no legal duty to pay, because courts are impotent to make agreements. It is a limitation of the judicial power of federal courts and on purported constitutional grounds.

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it if petitioner does is to assume that Congress's purpose in permitting the loss be used as a tax deduction was not to ameliorate the impact of the loss upon the person sustaining it but to confer a windfall on one who had no loss at all! That is precisely the holding below.

[29]There was no contract to *remake* because there was no contract. Simply and bluntly, respondent took over and managed the entire tax matter for its own benefit by controlling and directing petitioner's officers and agents.

Courts have been determining questions like these ever since 1602 when *Slade's Case*, 4 Coke 92b, gave rise to actions on a *quantum valebat* or *quantum meruit*:[30] where parties have failed to agree upon the compensation for goods sold or services performed, the very essence of the judicial function is to determine fair value. In innumerable other contexts courts must determine fair value, and the generalized definition of fair value is the "amount of money that can be obtained or must be given in exchange therefor by bargaining," 5 Corbin on Contracts (1951), p. 35, Sec. 1009.

As stated in just compensation cases under the Fifth Amendment, fair value is the "amount that in all probability would have been arrived at by fair negotiations between an owner willing to sell and a purchaser desiring to buy," *Olson v. United States*, 292 U.S. 246, 257.[31] Precisely the same test, in identical or almost identical words, will be found in authorities touching every field of law—e.g., conversion of personalty,[32] breach of contract to sell realty and personalty,[33] taxation,[34] bankruptcy,[35] disposition of all the assets of a corporation at an allegedly unfair price (a matter of close analogy here),[36] and state eminent domain cases.[37]

So also, in a variety of situations not involving valuation of property, courts must and do determine what would have been a

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[30]Plucknett, Concise History of the Common Law (4th ed. Butterworth) 610, II Street, Foundations of Legal Liability, 200; III Street 184, et seq.

[31]Also *United States v. Powelson*, 138 F.2d 343 (4 Cir.). The determination of this issue is a judicial function, *United States v. New River Collieries*, 262 U.S. 341.

[32]Bowers on The Law of Conversion (1917) p. 473.

[33]E.g., *Maxon v. Gates*, 136 Wis. 270, 116 N.W. 758, 765, (1908); *Joseph E. Seagram & Sons v. Bynum*, 191 F.2d 5, 11 (8 Cir.).

[34]E.g., *Whitlow v. Commissioner*, 82 F.2d 569, 572 (8 Cir.); *A. & A. Tool & Supply Co. v. Commissioner*, 182 F.2d 300 (10 Cir.).

[35]E.g., *Huber v. Moran*, 140 F.2d 823, 824 (8 Cir.).

[36]*Allied Chemical & Dye Corp. v. Steel & Tube Co.*, 14 Del. Ch. 64, 122 A. 142, 144.

[37]29 C.J.S. 974.

fair bargain,[38] as in transactions between dominating and dominated corporations or between interlocking directorates. In such cases, as said in *Pepper v. Litton,* 308 U.S. 295, 306,

> "The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain."

Not only may the contract be set aside, *Pepper v. Litton,* supra at 307, but the court may order one to pay another what an arm's length bargain would have reached. Cf. *Chelrob v. Barrett,* 57 N.E. 2d 825, 293 N.Y. 442; 61 Harvard Law Review at 339.

DIFFICULTIES IN DETERMINATION MUST BE RESOLVED AGAINST RESPONDENT, WHO CAUSED THEM.

If difficulties may be encountered in determining what an arm's length bargain would have been, that is no obstacle. The court simply takes "into account all considerations that fairly might be brought forward and reasonably be given substantial weight in such bargaining." *Olson v. United States,* supra, at 257. If the difficulties are insuperable, petitioner should receive the whole of the tax savings, for the reason why no bargain was made was that respondent denied petitioner the opportunity of seeking a bargain by unilaterally seizing and using the loss. *Meinhard v. Salmon,* 164 N.E. 545, 249 N.Y. 458 (per Cardozo, C. J.). This, too, is an old principle, *Armory v. Delamirie,* 1 Str. 505, 1 Smith's Leading Cases (Hare & Wallace Ed.) 589, expressed in the maxim *"omnia praesumuntur contra spoliatorem."*

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[38]A recent example in a tax context is *Helvering v. Safe Deposit Co.,* 316 U.S. 56. There taxability depended on whether relatives of a decedent took as appointees or as heirs. They had claimed as both and had settled with other claimants without allocation between the alternatives. This Court remanded the cause to determine what percentage of the settlement should be attributed to each alternative, i.e., to determine what bargain the parties would have made.

III.

Claims Cannot Be Barred for Failure to Present Them in Federal Railroad Bankruptcy Proceedings When They Arose After Revesting of the Properties in the Reorganized Debtor or Where, as a Condition of Revesting, the Latter Assumed All Liabilities and Obligations of the Trustees.

Among the new reasons advanced in the last opinion below in support of its decision, is the following (R. 2372):

> "No claim was presented to that [bankruptcy] court although the final order of discharge was not made until two years after the filing of the consolidated return [sic] claiming the offset."

But this can be no reason for denying petitioner recovery, because petitioner's claims arose *after* the bankruptcy court had returned the railroad's assets to respondent and *after* the trustees had surrendered control of operations (R. 2215). That surrender and revesting occurred on December 31, 1944 pursuant to a "Revesting Order" of the previous November 27th (R. 36).

The claim for refund of 1942 taxes and the 1944 tax returns, using petitioner's loss, were filed thereafter (R. 2217). They were the acts of respondent, not of the trustees.

It is irrelevant that the income to which the documents pertained accrued prior to the revesting. Pursuant to express requirement of the revesting order,[39] respondent assumed the obligation to pay taxes on that income. To meet that obligation it paid the 1942 taxes and set aside reserves of $10,100,000 to pay the 1943 and 1944 taxes, reserves which it still holds to await the outcome of this suit (R. 517, 518, 614, 616, 1818, 1824). After the revesting the liability to pay taxes was the reorganized respondent's, not the trustees', and it, not they, then utilized petitioner's loss and rights to discharge that liability.

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[39] Paragraph 9e thereof provided that respondent must

> "assume liability for, and pay in due course, any and all taxes lawfully due to the United States from the debtor or the debtor's Trustees for any taxable period prior to January 1, 1945 * * *." (R. 36 at 49)

By an "Agreement of Assumption" respondent assumed that liability in the same words (R. 1716).

As respects the 1943 taxes also, petitioner's claim for the tax savings accrued only when there were tax savings, i.e., in August 1947, when the Treasury accepted the returns pursuant to a settlement wholly negotiated and effected by respondent after it emerged from the reorganization (R. 262, 468). And could it be said that the claim arose in any part theretofore, respondent assumed the liability by express agreement.

The revesting order, as stated by Judge Fee (R. 2253, fn. 18), put respondent "under bond to pay all claims against the trustees." It fixed the date of the consummation of the plan of reorganization as December 29, 1944, provided that respondent should be discharged from all liabilities "except as herein provided" (R. 52) and "directed" it to execute an Assumption Agreement in prescribed form (R. 45, 46, 76). That agreement was executed by respondent in December 1944, whereby it agreed to

> "2. Assume any and all outstanding current liabilities and obligations incurred by said Trustees * * * and generally any and all liabilities and obligations with respect to claims of any character whether heretofore *or hereafter asserted* arising out of the possession, use or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business, including liabilities and obligations hereafter arising up to midnight December 31, 1944." (R. 1711, 1713)

Thereby, as a later order recites, respondent "assumed and agreed to perform all * * * liabilities and obligations of the Trustees remaining in effect on December 31, 1944" (R. 1987, 1988).

The court below now holds that claims which arise after revesting, or which are assumed as a condition of revesting, are barred for nonpresentation to a bankruptcy court. Such a rule gives a railroad, once reorganized, a perpetual tutelage, a position of immunity from the consequences of its conduct possessed by no one else. As stated by Judge Fee below it is "inconceivable,"[40] it

[40]"It is inconceivable that a decree of reorganization prevents the company, when released from tutelage, from entering engagements and incurring liabilities. Otherwise, the organization would be perpetual. See *In re Portland Electric Power Co.*, 97 F. Supp. 857, 873." (R. 2252, fn. 10)

is contrary to reason, it conflicts with the Sixth Circuit in a case involving the same section of the bankruptcy act (*Seaboard Air Line R. Co. v. Savannah Union Station Co.*, 181 F.2d 267 (5 Cir.)), and it conflicts with *Texas and Pacific Railway Company v. Johnson*, 151 U.S. 81, 103, where it is said that there is no principle whereby a court

> "could part with its jurisdiction over property by the complete surrender thereof to its owner, and at the same time constructively retain jurisdiction over such property so as in that respect to bind those who would otherwise be unaffected by its orders."[41]

THE CLAIMS WERE NOT DISCHARGED BY ANY ORDER IN THE BANKRUPTCY PROCEEDINGS.

The last opinion below next asserts (R. 2372):

> "The final order of the bankruptcy court provided that the assets of the reorganized company were to be 'free and clear of all rights, claims, liens and interests of the former stockholders * * *' There is no power in the District Court sitting in an independent proceeding in equity to alter, modify or amend the bankruptcy orders."

But what was actually said by the passage in the "final order" here mentioned was that "The court further finds and concludes" that the assets of the reorganized company

> "vested in and became the absolute property of the Western Pacific Railroad Company on December 29, 1944 free and clear of all rights, claims, interests, liens and encumbrances of former stockholders and creditors of the debtor company and all other persons *except as otherwise provided and directed in the order of this Court in this proceeding dated and entered November 27, 1944* * * *." [R. 109]

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[41]Here the reorganization court did not even purport to reserve jurisdiction to supervise claims arising after the revesting. Nor could it. As said in *Reese v. Beacon Hotel Corporation*, 149 F.2d 610 at 611 (2 Cir.): "* * * reservation of jurisdiction beyond what is requisite to effectuate a plan of reorganization is beyond the power of the reorganization court." Here the plan was formulated, approved and confirmed before anything was done that eventually led to the tax savings. Cf. *Callaway v. Benton*, 336 U.S. 132.

This order of November 27, 1944 was the "revesting order" just discussed (R. 36). As noted, it required respondent to assume, and under it respondent did assume, any liabilities arising from the trustees' acts.

Thus, while the bankruptcy court discharged the stockholder's equity *qua* stockholder and such claims as had existed against the debtor prior to the onset of the bankruptcy in 1935, it did *not* discharge liabilities arising from the trustees' operations. On the contrary, the latter were assumed.

This was precisely in accord with practice and the policy of the law in such matters. At the moment of the consummation of any plan of reorganization under Section 77 of the Bankruptcy Act, four possible classes of liabilities may exist: (1) personal liability of the debtor itself for *its* own debts, i.e., those existing at the onset of the reorganization proceedings; (2) liability of the assets in the trustees' hands to pay those debts and to cover the stockholder's equity as stockholder; (3) personal liability of the trustees to pay obligations arising from *their* operations; and (4) liability of the assets to pay the last named class of obligations. The policy of the law upon consummation of a reorganization plan is to discharge or remold claims of the first two classes and discharge those of the third class, but not to discharge the fourth. The integrity of courts and their officers requires that the fourth be preserved. The settled method of doing so in railroad receiverships was to require these to be assumed by the party to whom the assets were transferred.[42] That policy was carried into Section 77.[43] While subdivision (f) thereof provides for discharge of both the debtor and the assets from claims existing at the commencement of the proceedings and for discharge of the trustees personally, it

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[42]*Texas & Pacific Railway Co. v. Johnson,* 151 U.S. 81; *Texas & Pacific Railway Co. v. Bloom,* 154 U.S. 636; *Hanlon v. Smith,* 175 Fed. 492; Clark on Receivers (2d ed.) Sec. 494, p. 666; *Bartlett v. Cicero L. H. & P. Co.,* 177 Ill. 68, 52 N.E. 339, 341, 342; Glenn on Liquidation, Sec. 165, p. 273; *Stuart v. Dickinson,* 290 Mo. 516, 235 S.W. 446; *Anderson v. Chicago R. I. & P. R. R. Co.,* 189 Iowa 739, 175 N.W. 583; 45 Am. Jur. 276, Sec. 345.

[43]The provisions of Section 77 "carr[y] with [them] the application to railroad reorganizations of decisions and authorities originally applicable to equity receiverships." 5 Collier on Bankruptcy (14th ed.), p. 493.

makes no provision to free the assets from liabilities arising from the trustees' acts.[44]

Here the Assumption Agreement carried out the policy of the law. One of its necessary purposes and effects was to permit early personal discharge of the court's officers and to that end to permit claims arising from trustees' acts to be determined in independent suits after the bankruptcy proceedings had terminated.[45]

AN OBLIGATION TO PAY FOR RIGHTS OF ANOTHER SEIZED AND TAKEN QUIRED NO PRIOR APPROVAL OF THE BANKRUPTCY COURT.

The last opinion below also states "that any bargain that might have been effected at the time of the transaction would have been subject to approval of the bankruptcy court" (R. 2372). This remark cannot possibly have been directed to the 1944 return and the claim for refund, since they were filed after the revesting.

As to the 1943 return, while it may be true that court officers may not enter into express contracts without approval, failure to approve does not mean that the other party must transfer his rights for nothing. No bankruptcy court can dictate to one not in bankruptcy the terms on which he must transfer his property to a bankrupt's trustees (*Callaway v. Benton*, 336 U.S. 132). Nor may a court officer unilaterally take another's property, money, rights or other things of value to the enrichment of the estate and yet not subject the enriched estate to liability, merely because the court had not authorized him to enter into an express contract on the subject. *In re Hunter*, 151 Fed. 904; *Thompson v. Texas Mexican R. Co.*, 328 U.S. 134.[46] Court officers are peculiarly bound by obligations

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[44]Pertinent text of Section 77(f) is set forth in Appendix I hereto.

[45]It therefore is unnecessary to dwell on the further fact that the complaint herein stated that it was filed not only as an independent bill in equity but also as "an ancillary dependent suit within the jurisdiction reserved by this Court under its order dated March 28, 1946" in the bankruptcy proceedings (R. 6).

[46]A trust estate, enriched by unauthorized acts of the trustee, must account (Restatement of Trusts, Sec. 262; 2 Scott on Trusts, Sec. 269 to 269.3), as in the case of funds of another used to pay taxes on trust property (Restatement, Sec. 269, Comment a, Illustration 1). Cf. *Whiting v. Hudson Trust Co.*, 138 N.E. 33, 234 N.Y. 394 (per Cardozo, J.), and *Central Trust Co. of New York v. Ohio Central R. Co.*, 23 Fed. 306.

arising on principles of unjust enrichment, *Mosser v. Darrow*, 341 U.S. 267.

Moreover, an unauthorized act, if not binding on a receivership or estate, nevertheless creates a personal liability of the receiver or trustee. *Haines v. Buckeye Wheel Co.*, 224 Fed. 289, 297 (6 Cir.), cer. den. 242 U.S. 643; *In re Erie Lumber Co.*, 150 Fed. 817; 1 Gerdes on Corporate Reorganizations 617; 1 Clark on Receivers (2d ed.) p. 527. Hence, if any liability for tax savings relative to 1943 arose before the revesting, it was a liability of the trustees, and it became respondent's liability under the Assumption Agreement.

IV.

If An Issue of Fact Not Found on by a Trial Court Is Thought Material, the Cause Should Be Remanded for Findings Thereon. The Court Below Exceeded Its Appellate Office by Making Findings Ab Initio to Affirm the Judgment Upon a Legal Theory Different from That on Which the Trial Court Acted, and These Findings Were Contrary to What the Trial Court Made Clear It Would Have Found, Had It Considered the Issues Material, as Well as Contrary to Some Actually Made.

In its basic opinion of October 1951 the court below advanced as another ground of decision the factual assumption that petitioner, not respondent, filed the tax returns, and that respondent did not dominate and use petitioner's officers. Speaking of this, 65 Harvard Law Review at 1258 commented that the moment the issue of control is determinative "it would seem necessary for the court to have remanded to the district court for findings on that issue." Judge Fee had made the same protest, stating that "Findings must be made in the Trial Court. Appellate courts have no such right or function." (R. 2241).[47]

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[47]His dissent continued:

"The majority opinion attempts to accomplish justification of the result below by drawing inferences, deductions and conclusions from evidence which they claim to find in the record. * * * The very reason that Rule 52 requires findings of fact is illustrated by the majority opinion. For the technical difficulties of finding a basis of fact for this judgment are * * * insurmountable."

Our subsequent petition for certiorari and later brief in this Court in No. 150, Oct. Term 1952, discussed the subject fully.[48] In summary we noted the unprecedented nature of what the court below had done: An appellate court has power to reverse a judgment when it believes the findings to be "clearly erroneous." But this is not such a case, for it affirmed the judgment. An appellate court also has power to affirm a judgment on a legal theory different from that of the lower tribunal, if its new theory is supported by facts found below. But this is not that kind of case, either. Here an appellate court has swept aside the trial court's legal theories as unsound (R. 2227-2228, fn. 12, and see fn. 21 at p. 17, supra) and in nevertheless affirming it has done so on a theory presupposing facts upon which the trial court has not found and the very reverse of what that court, after hearing the witnesses and presiding over a living trial, has said it would have found had it deemed them material. "It is not the function of [an appellate court] to search the record and analyze the evidence in order to supply findings which the trial court failed to make." *Kelley v. Everglades Dist.*, 319 U.S. 415, 421; *Securities & Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 88. A reversal should follow failure to find at all on an issue held to be material. *Interstate Circuit Inc. v. United States*, 304 U.S. 55.

The situation has now been aggravated. This Court directed the court below to reconsider our petition for rehearing. That petition had complained that the court had presumed to find facts. Yet, in its opinion again denying the rehearing—i.e., in the very course of denying any opportunity to the litigant to be heard *in any court whatever* with respect to findings on issues which the District Court thought immaterial—the court supports its action by encroaching even more sweepingly on the fact finding function.

After reasserting and extending its holding that petitioner was obligated to join in consolidated returns and to give the benefit of its loss to respondent gratis, the court bolsters its decision by stating (R. 2371):

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[48]See Appendix III hereto at pp. 15 to 21.

"The use of a right to set off by filing a consolidated return was the equivalent of a transfer voluntarily made, and was an executed contract."

This, of course, is simply an assertion that petitioner made a voluntary gift of its loss to respondent, knowingly and deliberately,[49] and therefore may not recover.

PETITIONER HAD NO POWER TO MAKE A GIFT.

This is "strange doctrine," as Judge Fee had called it when it was suggested but not yet fully asserted.[50] Petitioner is a corporation.[51] A corporation cannot make gifts of its propery (except in limited matters of public charities[52] or possibly in expectation of pecuniary benefit). Even a majority of the stockholders could not make a donation of all the corporate property (13 Fletcher

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[49]The opinion cites, as support, Restatement of Restitution, Sec. 1(c), p. 13. That citation relates to the case of "one who makes a gift or voluntarily pays money." The subject is expanded upon in Sec. 112, et seq., which relate to "benefits voluntarily conferred without mistake, coercion or request." Sec. 112, comment a, states that the rule underlying all examples of denial of recovery is the "principle that a person who *officiously* confers a benefit upon another is not entitled to restitution therefor." The Restatement emphasizes (p. 463) that "restitution should be granted in accordance with the principle that compensation for benefits conferred is denied only to officious intermeddlers or to persons who do not desire or who manifest no desire to have compensation for their services." And as said by the reporter of the Restatement, "In general one is entitled to recover for a benefit conferred unless he intended to make a gift or acted officiously." 2 Scott on Trusts, Sec. 269.3, p. 1520.

[50]He said (R. 2244): "* * * It seems to be assumed that the officers of plaintiff could give away the property right to file or refuse to file consolidated returns either voluntarily or acting under the control of defendant or the reorganization trustees. This is strange doctrine * * * a transfer of all the assets of a corporation * * * cannot be made even by a majority of the stock. Neither officers nor directors, without a vote of the majority, have such power. In this case it is of stellar importance that this right of plaintiff was its sole asset and that, upon appropriation thereof, it became insolvent."

[51]The cases cited by the court below, in its last opinion, *Shelley v. Board of Trade*, 87 Cal. App. 344, 262 Pac. 403, and *McMillan v. O'Brien*, 219 Cal. 775, 29 Pac. 2d 183, are simply cases of voluntary payments by individuals.

[52]Cf. Del. Corp. Law. Sec. 2(9), now 8 Del. Code, Sec. 122(9); Cal. Corp. Code, Sec. 802(g).

Cyc. Corp., 1943 Rev. ed., Sec. 5789, p. 103); "it is not for trustees to be generous with other people's money" (Ballantine on Corporations (1946), p. 228); "the majority stockholders have no power to give away corporate property against the protest of the minority" (*Rogers v. Hill,* 289 U.S. 582, 591; *Nemser v. Aviation Corp.,* 47 F. Supp. 515). *A fortiori,* corporate officers can make no gifts.

Moreover, the tax utility of petitioner's loss was substantially its only asset, and not even a corporation's Board of Directors, much less its officers, can transfer all or substantially all of its assets, even for consideration; approval of requisite proportions of the stockholders is required (Del. Corp. Law, Sec. 65; now 8 Del. Code Sec. 271). Even then the fairness of the transaction is subject to judicial inquiry. "The price to be paid * * * and such like questions, must all meet the test of the corporation's best interest." *Allied Chemical & Dye Corp. v. Steel & Tube Co.,* 14 Del. Ch. 1, 120 Atl. 486, 490, 491, 494; *Allaun v. Consolidated Oil Co.,* 16 Del. Ch. 318, 147 A. 257, 260, 261.[53]

Still other statements in the last opinion below seem unmindful of what one would suppose to be elementary law. For example, it is said (R. 2370):

> "It must be borne in mind that all the transactions were open and aboveboard and were carried on in plain sight of all concerned * * *"

This is not merely a "disintegrating erosion" of basic duties of fiduciaries condemned by equity (Cf. Cardozo, J. in *Meinhard v. Salmon,* 164 N.E. 545, 249 N.Y. 458); it is a shattering disruption. Trespassers and converters are not immune from liability because their trespass or conversion is open: "The publicity alone of an illegal and unauthorized act of the directors of a corporation does not make it legal or valid. * * * Trustees may [not] validate an illegal act by simply doing it openly." *Goodell v. Verdugo Canon Water Co.,* 138 Cal. 308, 314, 71 Pac. 354, 356.

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[53]Since petitioner is a Delaware corporation, we cite Delaware law. The rule, however, is general. Cf. Cal. Corp. Code, Sec. 3901.

In fact, respondent's conduct in taking and using petitioner's tax rights can be called "open and aboveboard" only in the sense that it resorted to no devices of concealment. But it did not disclose what it was doing to petitioner's board or any responsible disinterested officer owing no loyalties to respondent itself (See pp. 5, 6, supra). And if it be assumed that "in failing to claim for plaintiff the advantages of its position," those responsible acted "without improper intent," this, as Mr. Justice Jackson said, does not free respondent of the duty to account (345 U.S. at 377).

THE ASSERTION THAT PETITIONER MADE A GIFT IS AN INTRUSION ON THE FUNCTION OF FACT FINDING.

Moreover, it simply is not the fact that petitioner, a corporation, voluntarily transferred to respondent the use of its loss by way of gift. Respondent simply took that benefit. The trial court stated in its opinion that "* * * there is a preponderance of the evidence in favor of the plaintiff's contention of 'duality of control.'" (R. 272). And by "duality of control" it said that it referred to the allegations of the Supplemental Complaint

> "that the defendant through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant." (R. 264)[54]

Thereafter, on settlement of the findings, the trial court agreed that respondent and not petitioner had conducted the tax proceedings and had achieved this through control of petitioner. *"There is no question about that,"* it said (R. 468).

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[54]The last opinion of the court below comments (R. 2369, fn. 8) that petitioner's answer to a complaint in intervention denied all allegations of domination and control. The allegations so denied had been made by certain stockholders seeking to intervene on the charge that petitioner would not properly press this case. Subsequently petitioner filed its Supplemental Bill of Complaint (R. 208) in which it affirmatively alleged the existence prior to commencement of the suit of such domination and control for respondent's benefit and in disregard of petitioner's rights. This is the allegation which the trial court stated was supported by a preponderance of the evidence.

The trial court declined to embody these statements in formal findings simply because it refused to make findings on any fact not material to the reasoning on which it based its decision (R. 276).

If, under the different reasoning of the appellate court, the facts become material, there should be findings by the tribunal authorized by law to make findings.

CONCLUSION

We respectfully submit that this petition for certiorari should be granted and the judgment reversed with directions to enter judgment for petitioner.

Dated: San Francisco, California, October 23, 1953.

MOSES LASKY
FRANK C. NICODEMUS, JR.
NORRIS DARRELL
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Of Counsel:
BROBECK, PHLEGER & HARRISON

(Appendices follow)

APPENDIX I

STATUTES INVOLVED

1. Internal Revenue Code, Section 141.

"(a) *Privilege to file consolidated income and excess-profits-tax returns.* An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making consolidated income and excess-profits-tax returns for the taxable year in lieu of separate returns. The making of consolidated returns shall be upon the condition that the affiliated group shall make both a consolidated income-tax return and a consolidated excess-profits-tax return for the taxable year, and that all corporations which at any time during the taxable year have been members of the affiliated group making a consolidated income-tax return consent to all the consolidated income- and excess-profits-tax regulations prescribed under subsection (b) prior to the last day prescribed by law for the filing of such return. The making of a consolidated income-tax return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated returns shall include the income of such corporation for such part of the year as it is a member of the affiliated group. * * *

"(b) *Regulations.* The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making consolidated income- and excess-profits-tax returns and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income- and excess-profits-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability. * * *

"(c) *Computation and payment of tax.* In any case in which consolidated income-tax and excess-profits-tax returns are made or are required to be made, the taxes shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the last day prescribed by law for the filing of such returns; except that the tax imposed under section 15 or section 204 shall be increased by 2 per centum of the consolidated corporation surtax net income of the affiliated group of includible corporations. * * *

"(d) *Definition of 'affiliated group'.* As used in this section, an 'affiliated group' means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

"(1) Stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

"(2) The common parent corporation owns directly stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of at least one of the other includible corporations.

"As used in this subsection, the term 'stock' does not include nonvoting stock which is limited and preferred as to dividends.

* * * * * * *"

2. Internal Revenue Code, Section 730.

Relating to excess profits tax, this is similar to Section 141.

3. Internal Revenue Code, Section 23.

"*Deductions from gross income.* In computing net income there shall be allowed as deductions:

* * * * * * *

"(g)(2) *Securities becoming worthless.* If any securities (as defined in paragraph (3) of this subsection) become worthless during the taxable year and are capital assets, the loss resulting therefrom shall, for the purposes of this chapter, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

* * * * * * *

"(4) *Stock in affiliated corporations.* For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset. For the purposes of this paragraph a corporation shall be deemed to be affiliated with the taxpayer only if:

"(A) At least 95 per centum of each class of its stock is owned directly by the taxpayer; and"

4. Internal Revenue Code, Section 52.

"* * * In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control."

5. Bankruptcy Act, Section 77, subd. f (Act of July 1, 1898, as amended, 49 Stat. 911; 11 U.S.C., Sec. 205(f)):

"* * * The property dealt with by the plan, when transferred and conveyed to the debtor or to the other corporation or corporations provided for by the plan, or when retained by the debtor pursuant to the plan, shall be free and clear of all claims of the debtor, its stockholders and creditors, and the debtor shall be discharged from its debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan or directing such transfer and conveyance or

retention, and the judge may require the trustee or trustees appointed hereunder, the debtor, any mortgagee, the trustee of any obligation of the debtor, and all other proper and necessary parties, to make any such transfer or conveyance, and may require the debtor to join in any such transfer or conveyance made by the trustee or trustees. Upon the termination of the proceedings a final decree shall be entered discharging the trustee or trustees, and making such provisions as may be equitable, by way of injunction or otherwise, and closing the case."

6. R.C.P., Rule 52(a).

"In all actions tried upon the facts without a jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; * * *"

7. Treasury Regulation 104.

"Sec. 23.1. *Privilege of Making Consolidated Returns.*

"(a) Sections 141 and 152, as amended, give to the corporations of an affiliated group the privilege of making a consolidated return for the taxable year in lieu of separate returns. This privilege is given, however, for taxable years beginning after December 31, 1941, upon the condition that all corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to these regulations, and any amendments thereof duly prescribed prior to the last day prescribed by law for the filing of the return; and the making of the consolidated return is considered as such consent. * * *"

Sec. 23.15(b): *Liability of a Corporation in Bankruptcy or Receivership.*

"If, at the time of filing a consolidated return, one or more, but not all, of the members of the affiliated group are in bankruptcy under the laws of the United States or in receivership in any court of the United States or of any State, Territory, or the

District of Columbia, then the liability under paragraph (a) of each such member of the group with respect to the period covered by such return shall not exceed such portion of the consolidated tax liability for such period as the several corporations included in the consolidated return may, subject to the approval of the Commissioner, agree upon, or, in the absence of such an agreement, an amount equal to its liability for such year computed as if a separate return had been filed."

Sec. 23.16(a): *Scope of Agency of Common Parent Corporation.*

"Except as provided in paragraphs (b) and (c) of this section—

"The common parent corporation shall be for all purposes, in respect of the tax for the taxable year for which a consolidated return is made or is required, the sole agent, duly authorized to act in its own name in all matters relating to such tax, for each corporation which during any part of such year was a member of the affiliated group. The corporations, other than the common parent, shall not have authority to act for or to represent themselves in any such matter. * * *"

8. Treasury Regulation 109.

Relating to excess profits tax, this is similar to T. R. 104.

APPENDIX II

Opinions of Court of Appeals for the Ninth Circuit Rendered After Mandate of Supreme Court in No. 150, Oct. Term, 1952

[caption omitted] June 12, 1953

Before DENMAN, Chief Judge, and MATHEWS, STEPHENS, HEALY, BONE, ORR and POPE, Circuit Judges.

PER CURIAM.

On or about January 3, 1951, a division of this court consisting of Circuit Judge Healy and District Judges Fee and Byrne was designated and assigned to hear and decide this case. For that purpose, the division constituted the court. The division heard the case on February 28, 1951, and decided it on October 29, 1951.[1]

On December 17, 1951, three of the parties (Meredith H. Metzger, Henry Offerman and J. S. Farlee & Company) filed a petition for a rehearing and a rehearing en banc. On December 18, 1951, two of the parties (Western Pacific Railroad Corporation and Alexis I. du P. Bayard) filed a petition for a rehearing and a rehearing en banc. On January 30, 1952, the division made and entered an order denying the petitions of December 17, 1951, and December 18, 1951, for a rehearing and striking them in so far as they sought a rehearing en banc.[2]

On March 10, 1952, Western Pacific Railroad Corporation and Bayard filed a petition for leave to file a motion (1) to vacate the order of January 30, 1952, and (2) to reinstate the petition of December 18, 1951. The division requested that the petition of March 10, 1952, be considered and acted upon by the court en banc. The request was complied with. The court en banc considered the petition of March 10, 1952, and, on July 9, 1952, made and entered an order denying it.[3]

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[1]Western Pacific R. R. Corp. v. Western Pacific R. R. Co., 9 Cir., 197 F. 2d 994.

[2]Id., 9 Cir., 197 F. 2d 994, 1012.

[3]Id., 9 Cir., 197 F. 2d 994, 1013.

The Supreme Court granted certiorari[4] and, on April 6, 1953, vacated the orders of January 30, 1952, and July 9, 1952, and remanded the case to this court for further proceedings.[5]

On May 27, 1953, this court's Rule 23 (formerly Rule 25) was amended by adding thereto two new paragraphs reading as follows:

"All petitions for rehearing shall be addressed to and be determined by the court as constituted in the original hearing.

"Should a majority of the court as so constituted grant a rehearing and either from a suggestion of a party or upon its own motion be of the opinion that the case should be reheard en banc, they shall so inform the Chief Judge. The Chief Judge shall thereupon convene the active judges of the court and the court shall thereupon determine whether the case shall be reheard en banc."

Pursuant to the Supreme Court's decision of April 6, 1953, and this court's Rule 23, as amended, it is now hereby ordered by this court en banc that the petition of March 10, 1952, be and is hereby refered back to the division,[6] and that the division be and is hereby designated and assigned to consider that petition and to take such action thereon as may be proper, such action to be in conformity with this court's Rule 23, as amended.

POPE, Circuit Judge, dissenting:

Since any action taken by the division is, under this order, "to be in conformity with this court's Rule 23, as amended," this means that if the division is of the same opinion it was before then the case is at an end. When the various petitions presently remaining undisposed of were filed, amended Rule 23 was not in effect. Normally such a rule should operate prospectively, and upon future petitions only. To apply such procedure retrospec-

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[4]Id., 344 U.S. 809.

[5]Id., 345 U.S. 247.

[6]The petitions of December 17, 1951, and December 18, 1951, have never been, and are not now, before this court en banc.

tively in the circumstances of this case would in my opinion be an abdication of the duty which this court owes to these litigants.

I think our duty is a very simple one. It is solely to do the best we can. By that I mean that it is the duty of this court, as now constituted, to spare no effort to bring this important litigation to a right conclusion. We have here a case involving an apparently novel point of law. To date the judges who have considered its merits are equally divided as to who should win. Mr. Justice Jackson and Judge Fee think the plaintiff should prevail. Judge Healy and Judge Byrne think otherwise. There remain six judges of this court whose power to break this tie is clear. The question is, is it our duty to do so? I think it is. I cannot think of a situation more clearly requiring action rather than abstention, decision rather than avoidance. The case is now in our hands as a full court.[1] I think it is our duty to keep it there, to hear arguments on it, and to decide it.

(Endorsed:) Order and Dissent of Pope, C. J. Filed Jun. 12, 1953. Paul P. O'Brien, Clerk.

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[1]It would be possible to give what is said in the court's footnote 6 a meaning with which I would not agree. As the opinion of the Supreme Court discloses, there has been some difference of opinion among the judges of this court as to the significance of certain language used in our former opinion. (See 345 U.S. at p. 266.) Whether that language was what the court decided, or mere dictum, the Supreme Court at any rate quoted it at pp. 264-5 of its opinion, and proceeded to disagree with it. That language was: "Circuit Judges other than those designated to sit on such court or division are not members of it, and officially they play, and are entitled to play, no part in its deliberations at any stage . . . A petition for rehearing in any such case, whatever its form or wording, must necessarily be treated as addressed to and is solely for disposition by the court or division to which the case was assigned for determination." As the Supreme Court put it, if the quoted language of our former opinion was a ruling which "came as a mater of statutory construction . . . it rests on an erroneous interpretation of § 46(c)." Since the Supreme Court decision in this case it has been clear that any time a majority of all the judges of this court choose to order a hearing or rehearing en banc in any case whatever, they may do so.

[caption omitted] June 15, 1953

Concurring Opinion of DENMAN, Chief Judge:

In concurring with this order in which the Court of Appeals en banc divests itself of its jurisdiction of this appeal, it should be made clear that the question of a rehearing en banc is to be considered *de novo* by the division consisting of Judges Healy, Byrne and Fee. That that division has not yet considered the merits of the motion for such a rehearing en banc appears from that division's refusal to consider that motion in the following language:

> "Insofar as the petitions seek a rehearing en banc, they are stricken as being without authority in law or in the rules or practice of this court. See Kronberg v. Hale, 9 Cir., 181 F.2d 767."

This de novo consideration may lead to the conviction that, while it is useless for the same three judges themselves to rehear the case, nevertheless the case is of such significance that it deserves the attention of the court en banc. This appears from the following language of the Supreme Court's decision at pages 14 and 15 of its slip opinion:

> "Finally, it is essential to recognize that the question of whether a cause should be heard en banc is an issue which should be considered separate and apart from the question of whether there should be a rehearing by the division. The three judges who decide an appeal may be satisfied as to the correctness of their decision. Yet, upon reflection, after fully hearing an appeal, they may come to believe that the case is of such significance to the full court that it deserves the attention of the full court." (pp. 14, 15)

It should also be clear to the division that the court en banc has returned the case to the division without passing on or expressing any opinion on whether the following factors in the case are or are not sufficient to warrant a rehearing en banc. These factors are:

(a) That the case is described by the Supreme Court as "difficult and complicated litigation," p. 19 slip opinion, and that it is "as complicated as it is unique," p.1.

(b) That the amount involved in the case is stupendous, being $21,000,000, and that the issues are very intricate such as might invoke the pooled wisdom of all the circuit judges as stated in the opinion of Mr. Justice Frankfurter at page 4.

(c) That the Supreme Court deems this case so important that it granted certiorari on the merits as well as on the question of rehearings en banc; and

(d) Finally, that the appellate judges who have considered the case on the merits, i.e., Justice Jackson and District Judge Fee and Circuit Judge Healy and District Judge Byrne are divided equally on the merits of this "difficult and complicated litigation" involving this stupendous amount, upon which no circuit judge has written an opinion.

(Endorsed:) Concurring Opinion. Filed Jun. 15, 1953. Paul P. O'Brien, Clerk.

[caption omitted] August 20, 1953

UPON PETITIONS FOR REHEARING AND REHEARING IN BANC

BEFORE: HEALY, Circuit Judge
FEE and BYRNE, District Judges

HEALY, Circuit Judge

In its decision of April 6, 1953,[1] the Supreme Court vacated our order of January 30, 1952 (197 F.2d 1012), denying the petitions of appellants and intervenors for a rehearing and rehearing in banc, and also set aside the later order of the full court (197 F.2d 1013, 1016) denying leave to Western Pacific Corporation to file a motion to reinstate its petition. On June 12, 1953, the court in banc referred the matter back to this division for consideration and action in conformity with our amended

[1]Western Pacific Railroad Corp. v. Western Pacific Railroad Co., 345 U.S. 247, 267.

Rule 23. ..... F.2d ..... Accordingly, the original petitions for rehearing and rehearing in banc are again before us for disposition, this time in light of the Supreme Court's observations on the subject.

We turn first to petitioners' suggestion that the case be reheard by the full court. In the past in cases decided by a division rehearings in banc have been ordered in but four instances.[2] It has been the policy of the court to avoid the duplication of effort and the frustrations, delays and expense to litigants necessarily incident to such anomalous procedure except in situations of a very limited class, namely those in which intra-circuit conflicts appear to have developed,[3] or where the public interest in the administration of justice suggests that course.[4] No conflict exists or is claimed to exist in this instance, nor is there likelihood that any will develop in consequence of our decision; and while the case, like all cases, is important to the parties the public has no perceivable interest in the issues or in the outcome.

Nevertheless various considerations are pressed upon us for calling upon the full membership of the court to turn its attention to the litigation. One of these is that the case is "difficult and complicated." Perhaps so, but it has not been thought that the mere presence of difficult problems warrants a departure from the normal three-judge procedure so essential to the dispatch of the court's business. Numerous causes presenting questions of greater perplexity than the present annually find their way here and are decided by divisions of the court with no feeling on the part of the judges that the administration of justice will suffer if they be not thereafter turned over to the full bench for reargument and a second decision.

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[2]See 197 F.2d 1013, 1015, note 6.

[3]Hopper v. United States, 9 Cir., 142 F.2d 181; Southern Pacific Co. v. Guthrie, 9 Cir., 180 F.2d 295, id. 186 F.2d 926.

[4]Evaporated Milk Ass'n v. Roche, 9 Cir., 126 F.2d 467, id. 130 F.2d 843; Pacific Gas & Electric Co. v. Securities & Exchange Comm., 9 Cir., 127 F.2d 378, id. 139 F.2d 298.

But we are told that the amount at stake is so "stupendous" as to suggest a need that the "pooled wisdom" of the seven circuit judges be brought to bear upon the problem of who is entitled to it. We do not doubt that the case is important to the immediate parties, but what case that comes here is not? Surely the causes of all civil litigants are entitled to the same measure of attention on the part of the judges whether the amounts they involve be measured in terms of a few thousand or of millions. On the criminal side, where not infrequently the records present close and difficult questions of fact and law and where the liberty or life of the appellant is in jeopardy, the need for the exercise of such wisdom as the court possesses is certainly not less pressing than here. We are not disposed to inaugurate a practice which makes fish of one dissatisfied litigant and fowl of another; and unless the gates are to be opened to a flood of horizontal reviews it seems essential that we adhere to the principles which have guided us in the past. The normal court of three judges has functioned not only speedily but with a high degree of competence in the federal appellate system, and preservation of the right of the successful litigant to enjoy the benefits of that procedure should remain a matter of major concern to the judiciary.

Finally we are reminded by counsel that two of the judges who participated in the decision are district judges and only one a circuit judge. The intimation here, apparently, is that a court of appeals so constituted is inferior in quality or its decisions somehow lacking in the attribute of finality attendant upon other decisions of the court. If we were to accept this thesis, wholly insupportable as it is both in fact and law, we ought in fairness to discontinue the practice of availing ourselves from time to time of the invaluable service of district judges in the disposition of our business. On petitioners' theory the presence even of one district judge on a division may taint the result, since, as not infrequently happens, disagreement between the two participating circuit judges renders decisive the vote of the district judge.

In summary we conclude that the case is not of such significance to the full court as to warrant the latter's attention.

The case originally was briefed and argued by exceptionally able counsel. Prior to decision it had the painstaking study of the participating judges over a period of many months during which there were repeated conferences and exchanges of views. The petitions for rehearing have not produced in our minds a belief that the cause was wrongly decided or that another hearing would produce a different result.

In ruling on the petitions we do not propose to repeat what was said in the opinion or again to discuss the case at large. However, counsel have directed our attention to the comments of Mr. Justice Jackson in his dissent to the effect that "On the face of it, the conclusion would seem warranted that the plaintiff is entitled to what fair arm's-length bargaining would probably have yielded," and to his statement that he would reverse and remand for findings in accordance with the doctrine of unjust enrichment.[5] Our respect for the pronouncements of the Justice do not permit us to leave his comments unnoticed.

It is of course true that the California courts, in common with the authorities generally, recognize a cause of action based on unjust enrichment. We do not, however, regard the doctrine as applicable here inasmuch as the appellant[6] has not sustained the burden of showing that appellee Western Pacific Railroad Company has in its possession money or property which came into its hands under circumstances which make it unjust to retain it, and which in equity and good conscience belongs to the appellant. The latter is claiming moneys which were earned through the operation of railroad properties in a trust estate administered for the benefit of unpaid creditors of its former wholly-owned subsidiary. It contends that had it not joined in the filing of consolidated tax returns the trust estate (appellee's predecessor) would have been required to pay these moneys to the United

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[5]345 U.S. 247, 273.

[6]In this discussion the term "appellant" has reference particularly to Western Pacific Railroad Corporation, and where necessary to the sense of what is said applies also to the remaining parties who claim to be aggrieved.

States; and that, the tax saving having been effected, appellee should be required to pay these moneys to the appellant.[7]

The title to and possession of the railroad properties were in the reorganization trustees who administered the operating company under the supervision of the United States District Court for the benefit of the unpaid creditors. These creditors had acquired their equities at a time when the operating company was wholly owned and controlled by the appellant. The reorganization trustees were appointed by the court; one of them was appellant's president and was appointed trustee upon appellant's recommendation. All of the officers and employees who acted in a dual capacity for appellant and the reorganization trustees were first officers and employees of the former and were subsequently used by the trustees because of their familiarity with the work involved. Such procedure is common in reorganization proceedings and does not sustain an inference that the trust estate dominated the parent company.[8]

In our decision we discussed the obligations of a holding company to its subsidiary and creditors, and its duty not to attempt to appropriate to itself an advantage which the tax laws give the subsidiary. Without intending to detract from the soundness of that principle, we shall assume for present purposes that it would have been proper for appellant holding company to bargain and exact payment as the price of its cooperation. So assuming,

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[7]Lurking in the background of this case is a specious element which has no proper place in the decision, but which, when injected by innuendo, casts its shadow across the record. There is an insinuation that the creditors received a windfall of millions of dollars at the expense of the United States by reason of a loophole in the tax laws. Coupled with this insinuation is a Robin Hood philosophy that undeserved riches should be divided with the poor. Assuming, without conceding, that the creditors were unjustly enriched at the expense of the government, it would avail appellants nothing. The doctrine of unjust enrichment is applicable only when the property, in equity and good conscience, belongs to the plaintiff.

[8]In its answer to the complaint in intervention appellant denied "on its own behalf and on behalf of its officers and directors all allegations * * * of domination and control of the plaintiff [appellant], its officers and directors."

we must further assume that the bankruptcy court would have approved payment from the trust funds of an amount demanded by appellant as the price of its bargaining, and that the right to claim a tax offset which springs from ownership of stock that is completely worthless is not destroyed when the right to use the loss is determined to have a value of millions of dollars for bartering purposes.

It must be borne in mind that all the transactions were open and aboveboard and were carried on in plain sight of all concerned; that there was no fraud, deceit, unfairness, or overreaching; that the consolidated return was filed by appellant's president in accordance with the practice of previous years; that the general counsel for appellant, who is of counsel for that party in this proceeding, recommended the employment of the tax counsel who conceived the idea of including appellant's stock loss in the consolidated return and called the attention of appellee's predecessor to the tax advantage.[9]

The men who controlled appellant at that time knew that the tax saving could not be effected without their cooperation. They did not threaten to repudiate the established practice of past years and deny to the creditors an advantage that the tax laws gave them, nor did they demand tribute for their cooperation. With full knowledge of all the facts surrounding the transaction appellant chose to follow the custom of previous years and permitted the tax advantage to fall where the tax laws ordained. What was done was consonant with the practice of these corporations during many years of affiliation. In previous years appellant had benefited taxwise by using the loss of the subsidiaries, and

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[9]Mr. Frank C. Nicodemus, Jr., was called as an adverse witness and testified that he was general counsel for the appellant corporation and had been continuously since 1934; that he was chairman of a special tax committee of reorganized railroads that was organized in 1943 or 1944; that he recommended to the trustees that the tax firm be employed; that he was able to and did represent the corporation's claims to the best of his ability; that he did not take directions or instructions from anyone as to what legal advice he should or should not give the appellant; that he was never dominated or controlled in any way in any of his activities as counsel for the appellant.

no attempt was made to bargain or exact payment for such use when the shoe was on the other foot. The use of the right to setoff by filing a consolidated return was the equivalent of a transfer voluntarily made, and was an executed contract. Compare Shelley v. Board of Trade of San Francisco, 87 Cal. App. 344, 262 Pac. 403.[10] See also Restatement, Restitution, § 1c, p. 13.

Any bargain that might have been effected at the time of the transaction would have been subject to the approval of the bankruptcy court. No claim was presented to that court although the final order of discharge was not made until two years after the filing of the consolidated return claiming the offset. The final order of the bankruptcy court provided that the assets of the reorganized company were to be "free and clear of all rights, claim, liens and interests of the former stockholders . . . ." There is no power in the district court sitting in an independent proceeding in equity to alter, modify, or amend bankruptcy orders.[11]

This is not a case where the appellant corporation is seeking to rescind or repudiate the acts of its officers who included the tax loss in the consolidated return. If a rescission of the executed agreement were possible it would not benefit the appellant as there would be no tax saving and the appellant's position would be unchanged. There are several unusual facets to this case, but perhaps the most unique is the paradoxical position of the appel-

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[10]In that case the court said [p. 349 of 87 Cal. App.]: "The amount in question was paid without any mistake on the part of Shelley brothers, who were fully cognizant of every fact and circumstances preceding the making of the payment, and such payment was freely and voluntarily made and duly authorized by Shelley brothers, being made by their attorney. 'A voluntary transfer is an executed contract, subject to all rules of law concerning contracts in general; except that a consideration is not necessary to its validity. (Civil Code, sec. 1040).' "

Consult also McMillan v. O'Brien, 219 Cal. 775, 29 Pac.2d 183.

[11]In re Watts and Sachs, 190 U.S. 1, 27, 23 S. Ct. 718 (1903); Isaacs v. Hobbs Tie and Timber Co., 282 U.S. 734, 739, 51 S. Ct. 270 (1931); Moore v. Scott, 55 F.2d 863, 864-5 (CCA 9, 1932); Hanna v. Brictson Mfg. Co., 62 F.2d 139, 145 (CCA 8, 1932).

lant which seeks to confirm the acts of its officers and at the same time petitions the court to insert a provision in the executed agreement requiring the payment of tribute for its cooperation.

How could the courts remake the contract for the parties? How could this court or the district court determine "what fair arm's length bargaining would probably have yielded"? Bargaining presupposes negotiations to determine the maximum amount a buyer is willing to pay and the minimum amount a seller is willing to accept. Such activity is a matter of business administration, and is not a judicial function. A district court, like the court of appeals, is a constitutional court and "neither has any power or function other than what is strictly judicial." Commission v. Havemeyer, 296 U. S. 506, 518.

The petitions for rehearing are denied.

Judge Fee did not participate in this determination.

(Endorsed:) Opinion upon Petitions for Rehearing and Rehearing In Banc. Filed Aug. 20, 1953. Paul P. O'Brien, Clerk.

APPENDIX III

Reprint of Petition for Certiorari in No. 150, October Term, 1952

Western Pacific Railroad Corporation and Alexis I. duP. Bayard, its receiver, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered on October 29, 1951, and also to review that court's order of January 30, 1952 striking from the files their petition for rehearing en banc.

OPINIONS BELOW

[Omitted]

JURISDICTION

[Omitted]

QUESTIONS PRESENTED

1. [Identical with question 1A of present petition.]
2. [Identical with question 4 of present petition.]
3. [En banc question, omitted.]

STATUTES INVOLVED

[Omitted]

STATEMENT

[First 3 pages omitted, being substantially identical with pages 4 to 6 of Statement of present petition.]

BASIC AND INCONTROVERTIBLE FACTS SUMMARIZED.

1. Petitioner sustained a loss of $75 million when its stock in respondent became worthless.

2. It ceased to have any economic interest in respondent on March 15, 1943.

3. Respondent thereafter used petitioner's loss to discharge respondent's tax liability of $17 million.

4. Respondent conceived the plan of using petitioner's loss and carried it into execution by directing the action of petitioner's president, who was also an officer of respondent and in its exclusive pay.

5. Respondent's tax saving resulted from the conjunction of two elements. First, it had to obtain petitioner's joinder in consolidated returns. In addition, it had to use the loss. The loss was petitioner's loss.

Under these facts, petitioner contended that respondent must account for the benefits obtained by it through the use of petitioner's tax credits.

THE DECISIONS OF THE TWO COURTS BELOW.

The District Court held against petitioner on two legal theories. The Court of Appeals swept both of them aside as erroneous in law. The dissenting opinion of Judge Fee states the situation (R. 2239-40):

> "The Trial Court gives two reasons for decision against plaintiff: * * * Neither has any validity.
>
> "The major portion of the opinion of the Trial Court is devoted to the proposition that the 'tax escape' was a fraud upon the government, and therefore the proceeds were given to the defendant, an active wrongdoer, * * * The majority of this Court as the opinion shows, does not rely upon it.[5]
>
> "A second subsidiary theory was also advanced below with little emphasis. * * * This reason is as unstable as the first."[6]

The majority nevertheless affirmed the judgment, by (a) announcing a new principle of law (discussed at pp. 9-19 below), and (b) applying it to supposed facts not found by the trial court

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[5]The majority opinion states of the District Court's major theory, "We do not share this view" (R. 2227-8, fn. 12).

[6]The subsidiary theory was that petitioner's claim was somehow barred by the reorganization proceedings. The majority opinion makes no reference to it.

and contrary to what the court indicated it would have found had it believed the facts material (discussed at pp. 20-26 below).

STRIKING OF PETITION FOR REHEARING EN BANC.

[En banc discussion omitted]

REASONS FOR GRANTING A WRIT

The court below has decided important questions of federal law which have not been, but should be, settled by this Court, as well as an important question of local law in a way in conflict with applicable local decisions. The questions are of wide public interest, concerning the rights and duties of parties to federal consolidated returns under the Internal Revenue laws and Treasury regulations. The decision of these vital questions is not only erroneous but it is in conflict with decisions of the Second, Fourth and Fifth Circuits. Furthermore, the court below has so departed from the accepted and usual course of judicial proceedings, as to call for an exercise of this Court's power of supervision.

These reasons will be presented under three main heads.

The decision of the Court of Appeals is commented upon in the May, 1952, issue of the Harvard Law Review, where it is suggested that the decision is erroneous (65 Har. Law Rev. 1256-1258).

I.

The Decision Is Based on a Novel Rule of Law, Affecting Taxes, Corporate Reorganization, and the Law of Unjust Enrichment, Without Support of Any Known Principle or Authority.

The basic reasoning of the majority opinion is as follows: If respondent controlled petitioner, it had a fiduciary obligation to deal with it fairly (R. 2223). But it did not violate this duty in filing the consolidated returns or in the failure of the common officers to request and obtain an agreement for compensation for use of petitioner's tax rights, or in respondent's failure to give petitioner an opportunity to appoint independent officers who could have made such an agreement. These acts were not unfair,

said the court, because petitioner was under a duty to file such returns; it could not have demanded an agreement of compensation for doing so, all because petitioner was bound to give to respondent the benefit of its loss (R. 2237-2234).

The opinion sums up: "Equity will not permit a recovery as a substitute for a bargain which would have been unfair," i.e., no bargain for any compensation would have been fair (R. 2235). In short, it was petitioner's duty to give up its sole asset to respondent for nothing.

The majority opinion thus announces a new principle of law, viz.:

That wherever the tax laws permit two corporations to join in consolidated federal tax returns, and one has a loss and the other has income, the former must join with the latter and permit its loss to be used for the latter's benefit, without payment, consideration or compensation.

And since respondent was no longer a subsidiary of petitioner,[7] the principle as applied went further, namely:

A former parent is under a duty to join in a consolidated return and permit its loss to be used to satisfy the former subsidiary's tax, without consideration or compensation, even though it has no economic interest in the latter and can derive no benefit therefrom.

This is tantamount to holding that the income corporation can sue in equity for a mandatory injunction to compel the loss corporation to join and confer the benefit of its loss, gratis.

Fundamentally, petitioner is entitled to recover on the principles of unjust enrichment. Restatement of Restitution, Section 1. The discharge of respondent's tax liability by use of petitioner's loss was an enrichment as much as if respondent had taken dollars from petitioner and used them for this purpose. As stated in 65 Harvard Law Review at 1257, "If, as has been suggested, the Court should not have found that [petitioner] had a duty to file

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[7]As the opinion itself states, "when the returns and the claim for refund were filed, affiliation no longer existed" (R. 2230-1).

consolidated returns, then principles of restitution for unjust enrichment should have governed the decision."

RETENTION BY RESPONDENT OF THE BENEFITS RECEIVED FROM USE OF PETITIONER'S LOSS IN CONSOLIDATED RETURNS IS INCONSISTENT WITH THE RATIONALE OF CONSOLIDATED RETURNS AND THE PURPOSE OF CONGRESS IN ALLOWING THEM.

The principle underlying consolidated returns is this: A group of affiliated corporations is an economic entity and, unless the group as a whole in the conduct of the business enterprise shows a net profit, those who conduct the business—the parent's owners—have realized no gain. *Handy & Harman v. Burnet,* 284 U.S. 136, 140.[8]

The rationale "is the recognition of this common owner's right to set off against his gains in the one [corporation] his losses in the other [corporation]." *Duke Power Co. v. Commissioner of Internal Revenue,* 44 F.2d 543 at 545 (4 Cir.), cer. den. 282 U.S. 903;[9] *Alameda Inv. Co. v. McLaughlin,* 28 F.2d 81 (D.C. N.D. Cal.), aff'd 33 F.2d 120 (9 Cir.).

When the tax law permits one affiliate's profits to be offset against another's losses, its purpose and its effect is to benefit the ultimate owners of the business entity, i.e., the parent's stockholders. The means it adopts is the amelioration of the loss suffered by them because of losses of any one affiliate.

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[8]The legislative reports and similar material are conveniently assembled in II Montgomery's Federal Taxes, Corporations and Partnerships, 1946-47 issue, pp. 632, 633.

Consolidated returns were first required, but only for excess profits tax, by Treasury Regulation in 1917. This was validated by the 1921 Act. Consolidated returns were compulsory for both normal and excess profits taxes between 1918 and 1921, inclusive. They were permissive but not mandatory for 1922-1933, inclusive. They were not permitted, except in case of certain railroad corporations, from 1934-1939, inclusive. They were permissive for all corporations with respect to excess profits taxes in 1940 and 1941. In 1942 the Revenue Act, Section 141(a), extended the privilege to all corporations for all years after December 31, 1941, with respect to both normal taxes and excess profits taxes.

[9]This case contains an excellent statement of the history and purpose of consolidated returns and the concept of the economic unity.

Two principles are evident: (1) The tax saving should go to the ultimate owner of the economic entity, the parent, and (2) it should go to the party suffering the loss, to ameliorate it. So long as the economic unity continues, these two principles coincide. And they coincide here, because the loss used to produce the tax savings was the former parent's loss.

The majority opinion below permits the tax saving to be retained by the former subsidiary, after severance of the economic unity—the very event producing the parent's loss—without making restitution to the parent. Thereby it defeats both equities underlying the principles of consolidated income tax reporting. New owners of the former subsidiary are reaping a sheer windfall from the misfortune of the old owners. The income tax laws are subverted into a tool to enrich strangers to the economic entity for whose protection consolidated returns are permitted.

In *Woolford Realty Co. v. Rose,* 286 U.S. 319, this Court (Cardozo, J.) held that the use of consolidated returns did not permit a corporation to deduct from its profits the loss of an affiliate sustained in a year prior to affiliation. "The mind rebels against the notion that Congress in permitting a consolidated return" was willing to permit a corporation to profit by the loss of one who was a stranger when the loss was sustained.

Here is the converse situation, for the tax savings were claimed after the economic unity was severed. The mind rebels against the notion that, after that severance, respondent may confiscate the tax utility of petitioner's loss. In the words of *Woolford,* "to such an attempt the reaction of an impartial mind is little short of instinctive."

In his dissenting opinion below Judge Fee summarized the matter thus (R. 2248):

> "If we look at it realistically, but little question arises. If the plaintiff were still the owner of the stock of defendant, then the allocation of $17,000,000 to the defendant would be reflected in the increased value of its stock. The transfer of the stock left the right untouched. Since increase in value of stock in defendant no longer is of avail to plaintiff, there

should be another method of applying the remission to the loss."[10]

Senate reports on various revenue bills have justified consolidated tax reporting on the ground that "no ultimate advantage under the tax laws really results,"[11] and that "no improper benefits are obtained from the privilege."[12] On the basis of these passages, *J. D. & A. B. Spreckels Co.*, 41 B.T.A. 370, 375, held that "the framers of the statute [did not intend] that the privilege of making consolidated returns may be enjoyed in cases where the affiliation does not serve a business purpose, as distinguished from a tax-reducing purpose."

But, unless the tax savings here are applied to ameliorate petitioner's loss, an "ultimate advantage under the tax laws" has resulted, "improper benefits are obtained from the privilege," and only a tax reducing purpose has been served: respondent has escaped its taxes because an economic stranger had a huge loss. The District Court was understandably indignant at this result. "If I had the power," it asserted, "I would order these taxes paid to the United States. That would effectively dispose of the cause." (R. 270).

Yet it left the funds with respondent, the unjustly enriched party responsible for what was done. And the majority opinion

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[10]In *Bondholders, Inc. v. Powell*, 342 U.S. 921 (Jan. 28, 1952) and again in *Chemical Bank & Trust Co. v. Group of Institutional Investors*, 343 U.S. ..... (June 10, 1952), Mr. Justice Frankfurter notes that due to erroneous estimates of future earning power, valuable equities were forfeited in a series of railway reorganizations of which the first was *Ecker v. Western Pacific Railroad Corporation*, 318 U.S. 448. Here, although petitioner's stock in respondent was declared worthless in the *Ecker* case, respondent's earned income in 1942-4 was so large that a tax of $21,000,000 would have been paid had it not been discharged by the use of petitioner's loss. The creditors of respondent, not content with wiping out petitioner's equity in respondent and acquiring it for themselves, now contend that respondent, in addition, is entitled to use petitioner's loss, without accountability.

[11]Report of the Senate Finance Committee on the Revenue Bill of 1928, 70th Congress, 1st Session, Senate Report 960, p. 8.

[12]Report of the Senate Finance Committee on the Revenue Bill of 1932, 72nd Congress, 1st Session, Senate Report 665, at p. 9.

below, while disapproving the trial court's reasoning, permits its result to stand.

The consequence is that the revenue laws have been subverted and made absurd.

BY FIAT THE MAJORITY OPINION BELOW MAKES MANDATORY WHAT CONGRESS LEFT OPTIONAL.

The tax laws make clear that (1) only the parent corporation may file consolidated returns; that (2) there was no duty to file such returns; (3) that consolidated returns may be filed only if all affiliates join, and (4) that a parent is under no duty to a subsidiary, nor any affiliate to any other, to file consolidated returns, each being free to make its own decision on the basis of its own interest. Treas. Reg. 104, Sec. 23.11(a), 23.16(a), II Montgomery's Federal Taxes, Corporations and Partnerships, 1946-7, pp. 649-650. *Duke Power Co. v. Comm.*, 44 F.2d 543, 545 (4 Cir.) cer. den. 282 U.S. 903; *George A. Fuller Co. v. Commissioner*, 92 F.2d 72 (2 Cir.); *Trinity Building Corp. of New York*, 40 B.T.A. 1315.

By judicial fiat the court below makes mandatory what Congress and the Treasury left optional. Wherever consolidated returns may be filed with a resulting tax reduction to anyone, this decision decrees that they must be.

The rule so created not only confers on one corporation a right to use another's assets, but it does so free of any requirement of just compensation.

No principle supports such a right. Rather, as Judge Fee stated (R. 2242):

> "plaintiff had a property right to file or refuse to file consolidated returns, which could neither be given away without consideration nor cut off judicially without due process."

As he further stated (R. 2243):

> "Since, under the [tax] law, all corporations concerned must consent to the filing of consolidated returns, it is clear, contrary to the statement in the majority opinion, that plaintiff

had no duty requiring it to file these returns. Plaintiff had a legal right to refuse to file."

65 Harvard Law Review at 1257 comments:

"The ground relied on by the Court of Appeals was that * * * [respondent] could have violated no duty to act fairly since [petitioner] was under a duty to file the consolidated returns anyway. The court's argument that [petitioner] had such a duty, however, is not convincing. The Internal Revenue Code imposes no such obligation."

Moreover, there are many factors besides offset of losses which bear on the question whether it is advantageous to join in consolidated returns (cf. II Montgomery, Federal Taxes on Corporations, 1942-1943, pp. 492, 493-5). Burdens as well as advantages flow from such action. Thus each company joining in the return becomes liable for the full amount of taxes owed by the group (Treas. Reg. 104, Sec. 23.15(a); T.R. 110, Sec. 33.15(a)), and is subjected to requirements affecting its future tax situation. For example, by virtue of elimination of intercompany transactions, the basis at which property is held may be affected (T.R. 104, Sec. 23.38; Tr. 110, Sec. 33.38). In certain circumstances such returns must be filed in a later year (T.R. 104, Sec. 23.11(a); T.R. 110, Sec. 33.11(a)), although "future developments may make the filing of separate returns for future years more advantageous." (II Montgomery, p. 492). Here one consequence of petitioner's joining in the consolidated returns was to make it liable for any taxes payable by respondent. All this demonstrates how indefensible it is to hold that an independent company has any duty to assume such a liability and such possible disadvantages simply to benefit another company which wants to use its loss.

Still again Judge Fee observed (R. 2251):

"An incontrovertible proof of the proposition that plaintiff had no duty to apply the loss for the benefit of defendant may be cited. If plaintiff had sold a gold mine for a profit of over $75,000,000.00, its loss on the stock of the subsidiary could have been applied to offset any taxes against plaintiff.

In that event, the trustees in reorganization would have been required to pay taxes against the operating company. Once used, the power of applying the loss would be functus officii, and plaintiff would have received the entire benefit."

ONE'S RIGHTS OR PROPERTY MAY NOT BE APPROPRIATED MERELY BECAUSE HE CANNOT USE THEM PROFITABLY HIMSELF.

The last quotation from Judge Fee's opinion reveals the fallacy of the majority opinion.

If a prosperous corporation (e.g., Standard Oil Company) had owned respondent's stock, none would claim that it had to join in a consolidated return and give respondent the tax utility of its loss, without accounting for the benefit, for Standard could use the loss to discharge its own taxes.

But because petitioner was so unfortunate as to be left destitute and with no taxable income, the majority opinion applied a different standard. It argues that respondent "did not abuse its supposed dominant position because the officers and directors common to both corporations did not sacrifice Corporation's [petitioner's] interests to those of its subsidiary" (R. 2232). The reason given is that petitioner "had no income" and so "there was no possible way for it to achieve any tax advantage to offset the loss," whereas "its affiliate [respondent] did have use for the loss" (R. 2232). "Under this state of facts these officers had a positive duty to make use of the loss as they did" (R. 2233), that is, to give it to respondent, to satisfy the taxes that otherwise it would have had to pay.

This is merely to assert that a corporation able to dominate another may take its tax credits without compensation if it can profitably use them and the dominated corporation cannot.

Almost anyone can advantageously use another's property or rights—and will, if he can get them for nothing. But the opinion below stands alone in holding that he is entitled to do so as of right. Protection of one's assets from seizure or trespass by another has never depended on what use or profit he can make of

them. The contrary rule reflects itself in a host of instances in every field of law, of which a few are listed in the margin.[13]

A recent example is *Reading v. The Attorney General*, 1951 Appeal Cases 507, affirming *Reading v. The King* [1949] 2 K.B. 232, reviewed in Harvard Law Review for January 1952 at 502. There the Crown was held entitled to bribes received by a soldier through use of his uniform, although the Crown itself could never have used the uniform to earn bribes.

65 Harvard Law Review at 1257 comments:

> "[petitioner's] stock loss was an asset having value * * * even though [respondent] was the sole market and [petitioner] could utilize the stock loss in no other way."

The tax credit was petitioner's sole asset. The majority opinion has given to that fact the very reverse of its true significance. As Judge Fee pointed out (R. 2242):

> "* * * It seems to be assumed that the officers of plaintiff could give away the property right to file or refuse to file consolidated returns either voluntarily or acting under the control of defendant or the reorganization trustees. This is strange doctrine. * * * a transfer of all the assets of a corporation * * * cannot be made even by a majority of the stock. Neither officers nor directors, without a vote of the majority, have such power. In this case it is of stellar importance that this right of plaintiff was its sole asset and that, upon appropriation thereof, it became insolvent."

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[13] In the common law action of trespass *quare clausum fregit;* in suits for use of land where no injury has resulted and the owner could not itself have made use thereof, *United States v. Bernard*, 202 Fed. 728 (9 Cir.); in the field of eminent domain, cf. *Boom Co. v. Patterson*, 98 U.S. 403, 408, "property is not to be * * * regarded as valueless because he [the owner] is unable to put it to any use. Others may be able to use it * * *"; of patents, *James v. Campbell*, 104 U.S. 356, 358; *Bigelow v. RKO Pictures*, 327 U.S. 251, 265; of literary property, *Universal Pictures Co. v. Harold Lloyd Corporation*, 162 F.2d 354 at 368-370 (9 Cir.); *Stanley v. Columbia Broadcasting System*, 35 Cal.2d 653, 666, 667, 221 P.2d 73; in the field of unjust enrichment where recovery is measured by benefit received and not detriment sustained, *Edwards v. Lee's Administrators*, 96 S.W.2d 1028, 265 Ky. 418 (the famous *Kentucky Cave* case); *Restatement of Restitution*, Section 1, pp. 13, 15, Section 136, p. 553; in the fields of agency, 3 *C.J.S.* Agency Sec. 165; and trusts, 3 *Scott on Trusts*, Sec. 502, p. 2422; and in any other kind of fiduciary relationship, *Fleishhacker v. Blum*, 109 F.2d 543 (9 Cir.).

As 65 Harvard Law Review 1257 says:

> "[Respondent's] enrichment may have been unjust if, having caused [petitioner] to file the consolidated returns, it deprived petitioner of the opportunity to bargain for the value of its corporate assets: the right to use its stock loss for tax purposes."

CONFLICT WITH THE FIFTH CIRCUIT.

On the subject matter of this action, the appropriation of tax credits or rights belonging to one who could not use them by another who could, the decision below is in conflict with the *Shreveport Bank* cases, a series of decisions of the Fifth Circuit. *Connolly v. Commercial National Bank in Shreveport,* 189 F.2d 608, *Commercial National Bank in Shreveport v. Connolly,* 176 F.2d 1004, *Commercial National Bank in Shreveport v. Parsons,* 144 F.2d 231, cer. den. 323 U.S. 796, affirming *Leslie v. Commercial National Bank in Shreveport,* 28 F. Supp. 927.

There an insolvent bank transferred its assets to a new bank in pledge to pay its liabilities. The State imposed a tax on the capital stock of banks, assessable against the bank. In determining assessable value, the value of real estate owned by the bank was deductible from what would otherwise be the value of the stock. Reporting the real estate transferred to it by the old bank as its own, the new bank paid less taxes than it otherwise would. It was ordered to account to the old bank for the tax savings.

These cases not only hold, as 65 Harvard Law Review 1257 says, that "a tax saving may constitute enrichment," but they also make clear that the fact that one has a tax credit or advantage which he cannot himself use does not give another the right, free, to use it to his advantage. "The fact that the Old Bank suffered no loss * * * makes no difference." *Leslie v. Comm. Natl. Bank in Shreveport,* 28 F. Supp. 927, 933.[14]

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[14]The majority opinion dismisses the *Shreveport Bank* cases on the ground that the "new bank" was a "trustee." But there was no trust in the strict sense. There was a situation in which the officers were in dual relationship with respect to the two banks. *Leslie v. Commercial National Bank in Shreveport,* 28 F. Supp. 927, 933. The words "trust" and "trustees" are

The decision below is in conflict, also, with *Bankers Trust Co. v. Florida East Coast Car Ferry Co.*, 92 F.2d 450 (5 Cir.). That case recognized the duty of an affiliate to account for tax benefits obtained from consolidated reporting, to the party whose tax credits conferred the benefit.

CONFLICT WITH THE SECOND AND FOURTH CIRCUITS.

To justify its conclusion, the majority opinion below states that if the loss were respondent's and the income petitioner's petitioner could have compelled respondent to confer upon it the benefit of the loss by joining in consolidated returns.

This is in direct conflict with the Second and Fourth Circuits and the Board of Tax Appeals which held that a corporation, including one in bankruptcy, is free to join or not to join in consolidated returns as it sees fit.

In *George A. Fuller Co. v. Commissioner*, 92 F.2d 72 (2 Cir.) and *Trinity Building Corporation of New York*, 40 B.T.A. 1315, the Commissioner was upheld in refusing to accept consolidated returns filed by a parent and subsidiaries, because the trustees of a bankrupt subsidiary had refused to join. *Duke Power Co. v. Commissioner*, 44 F.2d 543 (4 Cir.), cer. den. 282 U.S. 903, reached the same conclusion as to such returns filed by two subsidiaries where the parent refused to join. The taxpayers were thus unable even to utilize the losses of those who did join.

PETITIONER WAS NOT A FIDUCIARY FOR RESPONDENT. THE REVERSE WAS TRUE.

To extend its rule of mandatory filing of consolidated returns to a situation where the parent-subsidiary relationship has been

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used in the *Shreveport* opinions because the courts were applying the "grand rule," the principle "that wherever a person clothed with a fiduciary character gains some personal advantage by availing himself of his situation as a trustee he becomes trustee of the advantage so gained * * *," and recognized that the rule "includes persons who are not trustees properly so called, but all those who stand in what is called a fiduciary position." Pound and Plucknett's *Readings on the History and System of Common Law* (3rd ed. 1927), p. 629; 4 *Pomeroy's Equity Juris.* (5th ed.), p. 263. On this principle respondent should account to petitioner.

severed, the opinion stated that a tax return is an historical document, that a fiduciary's duties with respect to matters arising during the fiduciary relationship continue through the period of winding up, and that the fiduciary who performs an act of winding up may not exact payment (R. 2234-5).

But petitioner was not respondent's liquidating agent nor its fiduciary. What makes one a fiduciary for another are the elements of dominance and the exercise of control and management. *Southern Pacific Company v. Bogert,* 250 U.S. 483 at 492; *North American Co. v. S.E.C.,* 327 U.S. 686 at 693; 65 Harvard Law Review, 1257. As said in 65 Harvard Law Review, 1257, "It may be strongly argued, then, that in the unique situation where the usual relationship is reversed, the subsidiary controlling the parent, the fiduciary duty is also reversed."

The majority opinion itself notes that after 1935 respondent "was no longer controlled by Corporation but by the trustees appointed by the bankruptcy court" (R. 2223) and that after adoption of the Plan of Reorganization "affiliation no longer existed" (R. 2231). The Plan cut off all possibility of a return of control, management, or financial interest. The loss arose from the Plan. The prior association could not impose the duty on petitioner to make a free grant to respondent of the only asset which the reorganization left petitioner, i.e., the tax utility of its loss.

On the contrary, by controlling petitioner's president so as to file the tax returns, respondent assumed a "determining position over the rights" of petitioner and thereby "owed an obligation to it". *Young v. The Higbee Co.,* 324 U.S. 204, 209, 210.

II.

If an Issue of Fact Not Found on by a Trial Court Is Thought Material, the Cause Should Be Remanded for Findings Thereon. The Court Below Exceeded Its Appellate Office by Making Findings ab Initio to Affirm the Judgment Upon a Legal Theory Different from That on Which the Trial Court Acted, and These Findings Were Contrary to What the Trial Court Made Clear It Would Have Found, Had It Considered the Issues Material, as Well as Contrary to Some Actually Made.

The majority opinion holds that petitioner may not recover although respondent appropriated its rights by dominating and controlling it. Concurrently, the majority reaches its decision by factually assuming that petitioner, not respondent, filed the tax returns, and that respondent did not dominate and use petitioner's officers. But, as said in 65 Harvard Law Review, at 1258, the moment "the issue of control [is] determinative of whether there could be recovery * * *, it would seem necessary for the court to have remanded to the district court for findings on that issue."

This is not a case where an appellate court has reversed a judgment because it believes the findings to be "clearly erroneous." What occurred here is, so far as we can find, unprecedented. Here an appellate court, sweeping aside a trial court's legal theories as unsound, has affirmed on a theory presupposing a set of facts upon which the trial court has not found and contrary to what that court has shown it would have found had it deemed them material, after hearing the witnesses and presiding over a living trial.

Nor is this a case where an appellate court, in affirming a judgment on a legal theory different from that of the lower tribunal, does so on the basis of facts found below which support the new theory. Here the legal theory is new and rests on facts found ab initio by the appellate court.

The majority opinion says (R. 2235):

> "The record is barren of evidence to support the contention that Corporation was dominated by the subsidiary,

> or that there was a breach of any duty owed to Corporation. As the trial court stated, 'The so-called "duality of control" much discussed and emphasized, is not important.' "

A casual reading of this extraordinary statement would suggest that the trial court had found absence of domination. But what the trial court said was this (R. 272):

> "Whether there was, or was not, 'duality of control' respecting the directorates of the two companies, appears to me to be not too important. *True, there is a preponderance of the evidence in favor of the plaintiff's contention of 'duality of control.'* "

And by "duality of control" it said that it meant

> "that the defendant through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant." (R. 264)

The trial court declined to find any facts not material to the two legal theories on which it based its decision. It concluded that "there is little factual dispute pertinent to the issue decided," i.e., pertinent to *its* legal theories (R. 276), and that "The so-called 'duality of control,' much discussed and emphasized, is not important in resolving the tendered issue", i.e., the issue deemed by it to be important (R. 274).

Contrary to an assertion in the majority opinion below, the trial court gave permission to counsel to submit findings only if *"they are limited to the issues involving the essential equitable considerations upon which the decision rests"* (R. 276).

Thus, after hearing all the witnesses and performing the function which the law assigns to a trial court, the District Court made clear that, had it believed the issue material, it would have found in accordance with petitioner's claim, i.e., that respondent controlled petitioner and by means of that control caused it to file the consolidated returns for respondent's benefit. The importance which this Court attaches to a trial court's ability to see

the witnesses face to face is shown by *United States v. Oregon Medical Society*, 343 U.S. 326, 339 (Apr. 28, 1952).

But the Court of Appeals held that the trial court erred, both in what it considered the "essential equitable considerations" and in its two legal theories, and therefore that its findings did not support its judgment.

In consequence the parties have never had an opportunity to submit, argue and settle findings on the issues on which the Court of Appeals based its decision.

Judge Fee's dissenting opinion clearly states the situation (R. 2241):

> "Thus the two grounds advanced [by the Trial Court] to sustain the judgment fail. The cause should be reversed for failure to state adequate findings to support the judgment. Findings must be made in the Trial Court. Appellate courts have no such right or function. The majority opinion attempts to accomplish justification of the result below by drawing inferences, deductions and conclusions from evidence which they claim to find in the record. It would be possible for other judges to set up a diametrically opposite set of facts from which a judgment in favor of plaintiff might be based. The very reason that Rule 52 requires findings of fact is illustrated by the majority opinion. For the technical difficulties of finding a basis of fact for this judgment are many. Indeed, such difficulties are insurmountable."

Earlier Judge Fee had said (R. 2239):

> "There are no findings of fact [by the Trial Court] which support the judgment of the Trial Court or the affirmance thereof by a majority of this Court. The cause should be remanded for this reason alone."

THE TRIAL COURT REFUSED ADDITIONAL FINDINGS BECAUSE IT DEEMED THEM IMMATERIAL IN ITS VIEW OF THE LAW, WHICH THE COURT OF APPEALS REPUDIATED.

Contrary to the majority's assertion, petitioner submitted to the trial court proposed findings going to an essential basis on which the majority decided the case (R. 277-279). Their purport was

to state that respondent and not petitioner had acted in the premises. Because of the limitation placed by the trial court on proposed findings that it would receive, petitioner was precluded from asking for findings on "duality" and "domination" as such. But the same facts bore on whether petitioner took part in the tax transactions so as to be party to the wrongdoing which the trial court believed had been worked on the government. Findings on these issues were requested (Cf. R. 462, 463).

On settlement of the findings the trial court said that it agreed with petitioner's proposed finding to the effect that respondent *and not petitioner* had conducted the tax proceedings and that respondent had achieved this through control of petitioner. "There is no question about that," the court said (R. 468).

Petitioner urged, with prescience, that the facts should be stated clearly in "a set of findings so that the whole subject can be properly appraised above" (R. 463). The trial court thought that everything mentioned by petitioner could be gleaned from its "opinion some place or another" (R. 476 and see R. 470), but indicated it would make a specific finding as requested.

In the end it failed to do so and adopted its opinion as its findings. Notwithstanding the clear position of the trial court on these issues, the Court of Appeals made a contrary finding.

WHERE A TRIAL COURT FAILS TO FIND ON ESSENTIAL ISSUES, THE CAUSE MUST BE REMANDED.

R.C.P. Rule 52(a) provides that the trial judge "shall find the facts." That rule "was advisedly made mandatory * * *." 5 *Moore's Fed. Prac.* (2d ed.), p. 2657, fn. 21.

Where a finding has been made in the trial court, a Court of Appeals may set it aside where it is "clearly erroneous" and may reverse the judgment in consequence. But when a Court of Appeals does not have the benefit of an initial finding on a material fact by the trial court, it may not itself supply it.

"It is not the function of [an appellate court] to search the record and analyze the evidence in order to supply findings which the trial court failed to make." *Kelley v. Everglades Dist.*, 319

U.S. 415, 421; *Securities & Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 88. A reversal should follow failure to find at all on an issue held to be material. *Interstate Circuit Inc. v. United States*, 304 U.S. 55.

The Courts of Appeals have repeatedly so stated the law.[15]

There is an essential difference in the function of an appellate court and a trial court. As stated in oft-cited *Saginaw Broadcasting Co. v. Federal Communications Commission*, 96 F.2d 554, 559 (D.C. Cir.), an appellate court's function is to compare (1) rulings with the law and (2) findings with the record, not to extract findings from the record itself. When it has no specific finding before it, it has nothing to compare against the record and should reverse. So also *Commissioner v. Kolb*, 100 F.2d 920 (9 Cir.).

The vice of exploring the record to find facts *ab initio* is not only that it involves the appellate court in a new kind of task, but that it deprives the litigant of an opportunity to be heard. No proper machinery exists in an appellate court to settle findings in the first instance.

THE MAJORITY OPINION SETS UP A NOVEL AND FALSE PRINCIPLE CONCERNING THE POWER OF AN APPELLATE COURT.

The majority opinion disposes of the lack of findings to support its theory by saying that "Findings are not a jurisdictional re-

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[15]E.g., *Waialua Agricultural Co. v. Maneja*, 178 F.2d 603, 607, 608 (9 Cir.): "It is not the function of an appellate court to make findings on its own account." "The absence of findings * * * leaves no pediment on which a judgment can stand"; *Jacuzzi Bros. Inc. v. Berkeley Pump Co.*, 191 F.2d 632, 638 (9 Cir.): "The law does not commit that function to us, but solely the power to reverse if his findings be clearly erroneous"; *Helbush v. Finkle*, 170 F.2d 41, 42 (9 Cir.): Where a determination "would necessitate findings on questions on which the District Court has made no findings * * * such findings should be made by the District Court, not by this Court"; *Paramount Pest Control Service v. Brewer*, 170 F.2d 553, 554 (9 Cir.): "This Court of Appeals has no power *ab initio* to consider" issues on which no findings were made.

So also *Jones v. Waterman SS Corporation*, 155 F.2d 992, 997 (3 Cir.); *Kistler v. Gingels*, 171 F.2d 912 (8 Cir.); *Campbell v. Campbell*, 170 F. 2d 809 (D.C. Cir.); *McClure v. O. Henry Tent & Awning Co.*, 184 F.2d 636, 639 (7 Cir.).

quirement of appeal," and that an appellate court "may waive the defect on the ground that the error is not substantial in the particular case," if it feels able to find the facts itself (R. 2236). It supports this assertion by citing three cases, *Mayo v. Lakeland Highlands Canning Co.*, 309 U.S. 310, *Goodacre v. Panagopoulos*, 110 F.2d 716 (D.C. Cir.), and *Hurwitz v. Hurwitz*, 136 F.2d 796 (D.C. Cir.).

This Court nowhere stated in the *Mayo* case that when a case comes up without findings on issues which the appellate court deems material, it may make them *ab initio*. Its opinion contained a statement that findings are intended to benefit appellate courts. That statement is converted by the court below into a declaration that if the appellate court decides to find the facts itself it may dispense with findings by the trial court.

In *Goodacre v. Panagopoulos* and *Hurwitz v. Hurwitz*, there was no lack of supporting findings, but merely informality or irregularity in the mode of expressing them.

SUPPOSED PAST PRACTICE IN FILING CONSOLIDATED RETURNS FURNISHES NO BASIS FOR THE CONCLUSION THAT PETITIONER MUST FILE SUCH RETURNS AFTER IT HAD LOST ALL FINANCIAL INTEREST IN RESPONDENT.

In good part the majority opinion's factual conclusion that the use of petitioner's loss for respondent's benefit was petitioner's undominated act is based upon the practice in earlier years of filing consolidated returns.

But the relationship of petitioner and respondent was completely changed by this Court's approval in 1943 of the I.C.C.'s Plan of Reorganization. Prior to that time petitioner was respondent's owner. Thereafter they were total strangers to each other. A practice once followed between husband and wife is not pertinent to what should be done between divorced spouses. As Judge Fee pointed out, dissenting (R. 2248):

> "It is said, although there are no findings, that the history of prior consolidated returns is controlling. Of course, it cannot probably be shown how plaintiff heretofore dealt

with a consolidated return after there has been a divorce from a subsidiary."[16]

Furthermore, the loss here resulted from worthlessness of petitioner's stock in respondent. Since the tax law did not permit such a loss to offset operating income until October 1942, there was no prior practice on the use of such a loss.

Petitioner's loss with its utility for tax saving was its sole asset. There was no past practice about giving away a sole asset.

Moreover, if past practice were relevant petitioner would be entitled to a finding thereon by the trial court.[17]

III.

It Was Error to Deny Petitioner the Right to Petition for a Rehearing en Banc

[En banc discussion omitted]

CONCLUSION

We respectfully submit that this petition for certiorari should be granted.

Dated: San Francisco, California.
June 19, 1952.

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[16]The trial court itself had said (R. 1377):
"I just don't see the point of what any affiliated company has done in the past as a matter of practice in these returns, because they have all been decisions that have been made by the parent company, and when the parent company decided that it was proper to file affiliated returns, it filed them, * * *. What we have in this case is not concerned with that."

[17]For the 11 years prior to the first tax year here involved, there was not a single year in which respondent had any income (R. 1263), and in the last 5 years of that period neither respondent nor petitioner had any income. The losses of neither were used to offset income of the other (R. 2040, 2041). In still earlier years a subsidiary group joining with petitioner in consolidated returns did account to petitioner for the resulting tax savings (D. Ex. 40).

FILED
NOV 12 19
HAROLD B. WILLE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. 463

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FABLER & CO., INC., *Petitioners,*

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD., *Respondents.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

(Following action taken below after remand by this Court in No. 160, Oct. Term 1952.)

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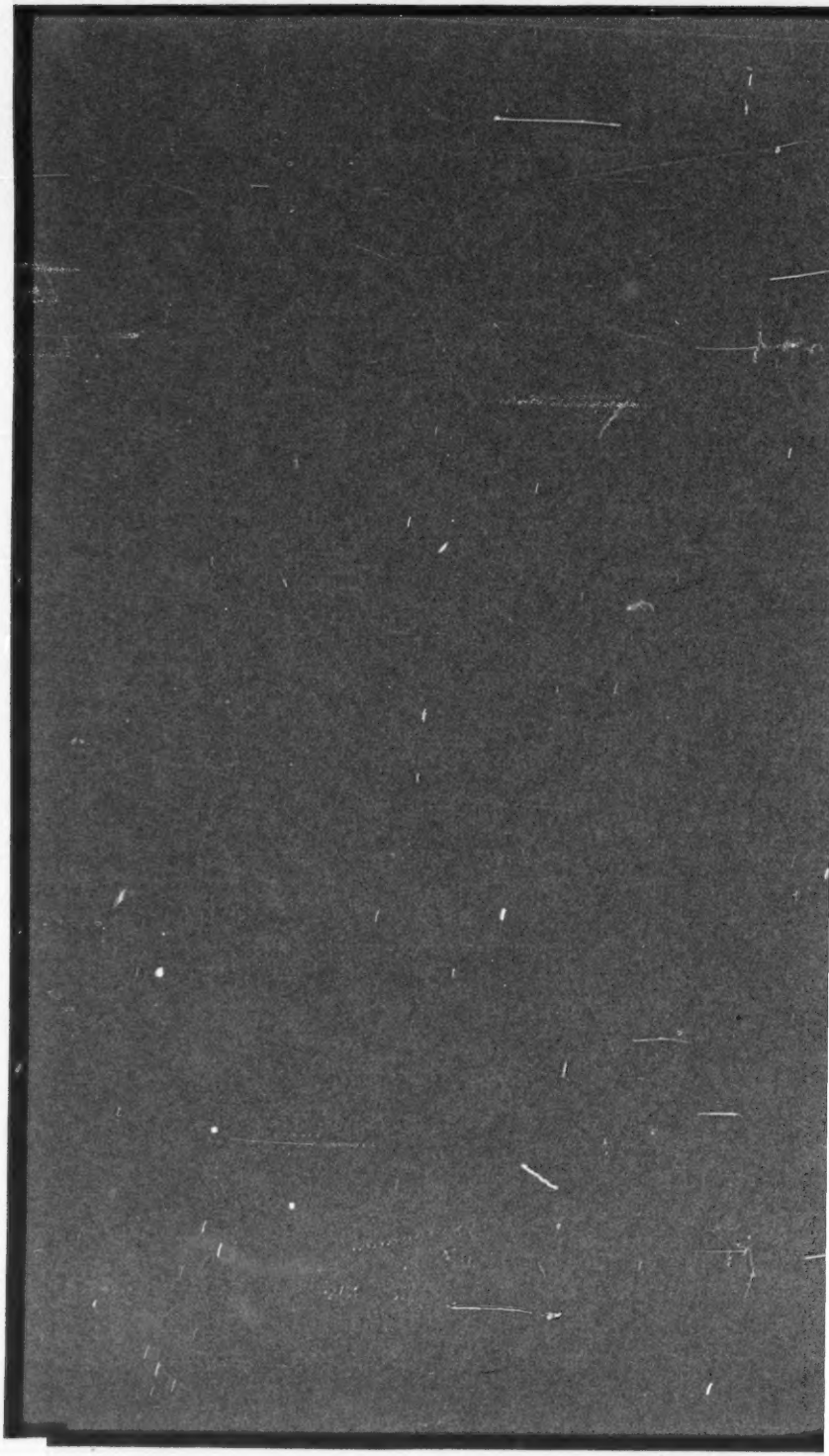


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CHRONOLOGY OF FACTS

Date	
1916	Plaintiff acquires all of the stock of respondent for $75,000,000.
1935	Respondent goes into reorganization.
1940	The District Court approves respondent's reorganization plan.
1943	
Mar. 15	The Supreme Court affirms the approval of respondent's reorganization plan.
June 1	Plaintiff's officers become full-time employees of respondent, paid solely by respondent.
1944	
Apr. 30	Plaintiff transfers its stock in respondent to respondent's reorganization committee.
July 15	Plaintiff files consolidated tax returns for 1943.
Dec. 29	Respondent emerges from reorganization.
1945	
Mar. 9	Plaintiff files the refund claim for 1942 taxes.
June 15	Plaintiff files consolidated tax returns for the first four months of 1944.
1946	
Oct. 10	Plaintiff institutes this action.
1947	
Feb. 11	Polk offers, in plaintiff's name, to settle the tax controversy with the Government.
Apr. 2	Polk notifies plaintiff of this offer.
Aug. 13	The Government accepts the settlement offer.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. .....

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE & CO., INC.,

Petitioners,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners Metzger, Offerman and Farlee, plaintiffs-intervenors below, pray for a writ of certiorari to review the judgment of the Court of Appeals of October 29, 1951, and its order of August 20, 1953, denying petitioners' application for rehearing and rehearing en banc. Petitioners are preferred stockholders of plaintiff and submit this application simultaneously with plaintiff's own petition.

Previous Opinions Herein

The fourteen judicial opinions heretofore rendered herein—prevailing, concurring and dissenting—are reported:

That of the District Court, at 85 F. Supp. 868 (R. 248);

Those of the Court of Appeals rendered before the remand by this Court, at 197 F. 2d 994 (R. 2214, 2239, 2260, 2261, 2288, 2296, 2313);

Those of this Court, after the grant of certiorari (344 U. S. 809), at 345 U. S. 247; and

Those of the Court of Appeals rendered after the remand, at 205 F. 2d 374 and 206 F. 2d 495 (R. 2354, 2356, 2359, 2363).

Jurisdiction

The judgment of the Court of Appeals was entered October 29, 1951 (R. 2255); its order denying petitioners' applications for rehearing en banc was entered August 20, 1953 (R. 2363).

The District Court had diversity of citizenship jurisdiction (R. 6, 12, 117-8) under 28 U. S. C., § 1332. The Court of Appeals had jurisdiction under 28 U. S. C., § 1291. The jurisdiction of this Court is invoked under 28 U. S. C., § 1254(1).

Statutes Involved

The pertinent portions of §§ 23(g)(4), 122 and 141 of the Internal Revenue Code, of Treas. Reg. 104, §§ 23.12, 23.15 and 23.16, of Rule 52 of the Federal Rules of Civil Procedure, and of § 66 of the (old) Judicial Code, 28 U. S. C. § 125 (old), are set forth in the Appendix hereto.

Statement

1. *Plaintiff's $75,000,000 stock loss.* In 1916, plaintiff, a holding company, acquired for $75,000,000 all the stock of respondent, an operating railroad company (R. 493).*

In 1935, respondent went into reorganization under § 77 of the Bankruptcy Act (R. 494). The reorganization plan, approved by this Court on March 15, 1943, *Eckert* v. *Western Pac. R. Corp.*, 318 U. S. 448, was consummated on December 29, 1944, when the reorganization trustees returned the assets to respondent (R. 499) and respondent assumed the obligations of the trustees (Pl. Ex. 15, R. 1711-3).

The plan provided that plaintiff's stock interest in respondent was without equity and not entitled to share in the assets (R. 259, 495). Plaintiff's $75,000,000 investment was thus wiped out.

2. *Plaintiff's tax credit and its use to save respondent's taxes.* Staggering as plaintiff's loss was, it presented one mitigating feature: The amount of the loss could be used as an income and excess profits tax deduction. I. R. C., § 23(g)(4), enacted in 1942 (56 Stat. 820), provides that losses resulting from the worthlessness of a stock investment in an affiliate are to be treated as operating losses (rather than as capital losses as theretofore).

Plaintiff's loss was so utilized, but plaintiff derived no benefit therefrom. Instead, the entire benefit of plaintiff's tax credit was reaped by respondent. This was accomplished through the mechanics of consolidated tax returns.

Under I. R. C., § 141, consolidated tax returns may be filed for an affiliated group of corporations headed by a common parent and inter-connected by at least 95% stock

* In the record plaintiff is sometimes called the "Corporation", respondent the "Company".

ownership. In such a return, the respective losses and profits of the affiliated corporations are offset against each other and taxes are paid only on the net profit of the group as a whole. Only the parent can file such a consolidated return (Treas. Reg. 104, §§ 23.12, 23.16).

Although this Court's decision of March 15, 1943, had rendered plaintiff's stock interest in respondent worthless, the reorganization was not actually consummated until much later; plaintiff's ownership of respondent's old stock continued therefore until plaintiff surrendered it to respondent's reorganization committee on April 30, 1944 (R. 260). For tax purposes, plaintiff remained respondent's "parent" and had the right to file consolidated returns for the year 1943 and the first four months of 1944 (hereafter referred to as the year 1944).

During this 1943-1944 period, respondent had earned profits from its wartime railroad operations on which it would ordinarily have had to pay more than $17,000,000 in taxes (R. 262). But respondent avoided the payment of this tax by causing plaintiff to file consolidated returns in which plaintiff's stock loss was offset against respondent's profits, relieving respondent from all tax liability. Furthermore, by virtue of the "carry back" provision of I. R. C., § 122(b), plaintiff filed, at respondent's behest, a claim for the refund of about $4,000,000 in taxes which respondent had paid for the year 1942 (R. 262).

The consolidated returns for 1943 were filed on July 15, 1944; those for 1944 on June 15, 1945; and the refund claim on March 9, 1945.

Thereafter, in August 1947, a settlement with the Government resulted in the approval of the 1943 and 1944 returns as filed and in the denial of the refund claim (R. 171-5, 262-3).

Thus respondent, instead of paying more than $21,000,000 in taxes for the period 1942-1944, paid only about $4,000,000. Respondent therefore saved $17,000,000 by using plaintiff's

tax credit (R. 266-7). But plaintiff, whose equity in respondent was wiped out, derived no benefit whatever from this use of its tax credit and the resulting enhancement of respondent's assets.

3. *The anomaly of respondent's retention of the entire tax saving and the denial of any tax benefit to plaintiff.* Normally, the tax credit arising from a stock loss—such as plaintiff's—redounds to the benefit of the party who suffered the loss. This is as it should be, since the tax deduction is designed to mitigate the loss.

Normally, this reasonable result obtains also where a parent corporation, in a consolidated return, deducts its loss from the earnings of a subsidiary. For the tax saving of the subsidiary redounds automatically—through dividends or through the increased value of its stock—to the benefit of the parent which, in an economic sense, owns the subsidiary's assets. Again this accords with the purpose of the tax law which permits consolidated returns in order to give the owners of an affiliated group of corporations the same tax benefits as the owners of a corporation doing business through various departments (see *infra*, pp. 19-21).

But this automatic achievement of the purpose of the tax laws completely failed in the present case; for the economic relationship between plaintiff and respondent had been severed; so that plaintiff derived no benefit whatever from any tax savings of respondent. The purpose of the tax laws was thus perverted: The prosperous respondent obtained a wholly gratuitous tax deduction for a loss which it had never suffered; while plaintiff's stock loss remained unalleviated by any tax advantage.

Plaintiff nevertheless had the means to cause the tax benefits to go where, in justice and by the spirit of the tax law, they belonged, namely, to plaintiff. For plaintiff had, as a matter of law, a free choice whether or not it would file consolidated returns (R. 1458). Before filing

them, plaintiff's management could have made suitable arrangements with respondent which would have assured plaintiff at least a substantial portion of the tax savings in mitigation of its loss.*

No such arrangements were sought or made. Instead, the tax savings were permitted to remain where they fell—in respondent's hands. This stupendous gift by plaintiff of a gratuitous $17,000,000 benefit to respondent has a simple explanation: The allegiance of plaintiff's officers, directors and attorneys to respondent, and their surrender to respondent's wishes and directions.

4. *The divided allegiance of plaintiff's management and the dominating role of respondent in the tax matter.* During the critical period in which the consolidated returns were filed, plaintiff's officers were actually subordinate employees of *respondent;* they received their entire compensation from *respondent,* none from plaintiff (Pl. Ex. 30, R. 527, 1738).

Thus plaintiff's president, Mr. Curry, was at the same time a vice-president and director of *respondent* (R. 719). Despite these weighty titles, Curry was actually but a chief clerk or office manager (R. 639); he considered himself "merely a signing officer" (R. 641) who signed whatever documents Schumacher (*respondent's* bankruptcy trustee) or Elsey (*respondent's* president) told him to sign (R. 642). Plaintiff's only other officer, Mr. Wienken (R. 1719), was actually a stenographer (R. 648); his successor, Miss Valouch (R. 1719-20), was actually a clerk (R. 530). Each of these three was, during the critical period, employed and paid exclusively by *respondent* (R. 645, 1738), and was subject to the inevitable tug of loyalty to his paymaster.

Plaintiff's board of directors presented, during this critical period, the same picture: A majority of its nine mem-

* Agreements of this type have been repeatedly approved by the Securities and Exchange Commission; see *infra,* p. 23.

bers were employees of *respondent* and received their compensation solely from *respondent,* none from plaintiff (Pl. Ex. 22, R. 1720; R. 1135-9). Among plaintiff's directors were: Respondent's reorganization trustee Schumacher, a telephone operator, a stenographer, three clerks and a lawyer paid by respondent and its trustees.

An important role in the tax matter was played by the attorneys for the parties. Plaintiff's general counsel, Nicodemus and Campbell (constituting the firm of Pierce & Greer), were simultaneously attorneys for *respondent* and its trustees (R. 793). For their services they were paid by *respondent* and its trustees (R. 534-8, 1730-1); but they received no compensation from plaintiff (R. 1723). Respondent's trustees instructed Nicodemus to protect *respondent's* estate in preparing the consolidated returns (R. 543-4).

The firm of Whitman Ransom Coulson & Goetz acted as tax counsel for both plaintiff and respondent (R. 544-7, 556, 1438-41). The firm's compensation, however, was paid solely by *respondent* (R. 548-57); and Mr. Polk (who was, together with Mr. Coulson, the partner in charge of the tax matter) baldly admitted that "my responsibility was to them [respondent] and not to the Corporation [plaintiff]" (R. 1431).

The allegiance of plaintiff's management and lawyers to respondent was strikingly demonstrated in the handling of the tax returns. At every stage, respondent made the decisions; plaintiff's role was confined to the mechanical, unquestioning and uninformed execution of respondent's wishes.

Thus tax counsel's recommendation that consolidated returns be filed was made only to respondent, not to plaintiff (R. 1267-8, 1410-11); plaintiff did not even receive a copy of the tax opinion Mr. Coulson rendered to respondent (Pl. Ex. 54, R. 605-610, 665). On the strength of this advice, and without bothering to consult plaintiff, respondent

simply decided * to use plaintiff's tax credit to eliminate its own taxes (R. 1448). Without so much as asking plaintiff, respondent reversed its tax accruals (R. 873, 1770) and stated that plaintiff "can and will" file consolidated returns in which plaintiff's stock loss "will result in elimination" of respondent's tax liability (Pl. Ex. 20-B, R. 512). The consolidated returns for 1943 were thereupon prepared by respondent's employees, under the supervision of Polk (R. 663); they were then placed before Mr. Curry, the "signing officer"; and Curry did just that: He signed (R. 664). He did so without consulting plaintiff's board of directors, without the advice of independent counsel, without understanding of tax matters, indeed without any thought whatever (R. 664, 808).

Roughly the same procedure was followed in connection with the returns for 1944 and the refund claim for 1942. Again, counsel advised respondent, but not plaintiff (R. 623). Again, the decision was made by respondent, not plaintiff (R. 1449-50). Again, the returns were signed by Curry, the "signing officer". Again, Curry omitted to consult plaintiff's board of directors or independent counsel (R. 666-7).

The same pattern also prevailed in the 1947 tax settlement with the Government. Polk secured a power of attorney from plaintiff (R. 1784) which Curry signed without consulting his board (R. 667-8). Thereafter Polk submitted to the Government a written offer of settlement (R. 171); its terms were approved in advance by *respondent's* board (R. 1429-30); while the thought of consulting plaintiff occurred to no one (R. 1431). Not until two months later did plaintiff's board learn of the settlement offer made in plaintiff's name (R. 1460-1, 1788). Despite the objections of plaintiff's board (R. 1794), Polk renewed his settlement offer (R. 1799); and it was, without advance approval by plaintiff's board, accepted by the Government (R. 174-5).

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* Respondent's decision (R. 1448) was made by Elsey, its president (R. 1251), and by DeGraff, its general auditor (R. 1408).

The evidence thus amply supports these findings of the District Court:

> "It was there [in the supplementary complaint] further alleged that the defendant [i.e., respondent] through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant. Throughout the proceedings and in the trial, this has been referred to as 'duality of control'" (R. 264).
>
> "* * * there is a preponderance of evidence in favor of the plaintiff's contention of 'duality of control'" (R. 272).

The Previous Proceedings and Decisions Herein

1. *The nature of the action and petitioners' position.* Plaintiff commenced this action in October, 1946 to compel respondent to account for the tax benefits it secured from the use of plaintiff's tax credit. Petitioners, who own about 6.7% of plaintiff's preferred stock (R. 1717) and who had previously brought a stockholders' suit involving the same claim (R. 337, 706-7), were permitted to intervene in this action in April, 1947 (R. 122).

Petitioners intervened principally to demonstrate what plaintiff had theretofore failed to allege: The managerial interlock between the parties and the control of plaintiff's management by respondent's trustees and agents (R. 131-146). These facts, we contended, subjected respondent and its trustees to the duty of according fair treatment to plaintiff in the tax transaction; and since the purpose of the tax laws was to confer a tax benefit on plaintiff—because plaintiff had suffered the loss and because it was the parent of the affiliated group—it would have been fair for plaintiff to obtain at least a substantial portion of the tax savings to be produced by the use of its tax credit. The dual allegiance of its management prevented plaintiff from

seeking and making timely arrangements to that end with respondent or its trustees and enabled respondent to appropriate plaintiff's tax credit to the sole benefit of respondent. A court of equity should therefore allow to plaintiff at least a fair share of the tax saving produced by its tax credit.

2. *The decision of the District Court.* The District Court, by Goodman, D. J., dismissed the action principally on a ground which had been neither urged nor briefed by any of the parties, namely, that respondent's tax "escape" was contrary to law and that equity should not compound this injustice by distributing respondent's illegal gain to plaintiff (R. 265-72). An additional ground was that respondent's reorganization plan eliminated plaintiff's stock interest in respondent and that this provision of the plan would be defeated if plaintiff were permitted compensation for the use of its tax credit arising from the worthlessness of its stock (R. 272-5).

3. *The decision of the Court of Appeals.* The Court of Appeals, by a divided court, affirmed. But the prevailing opinion of District Judge Byrne (R. 2214) completely rejected or ignored the grounds of the District Court (R. 2227-8, fn. 12). Briefly stated, the majority below held that the $17,000,000 should be left with respondent because that result was in accordance with the purpose of the tax laws (R. 2232, 2234); and because plaintiff owed respondent a legal duty to make its tax credit available to respondent through consolidated returns without sharing in the resulting benefits (R. 2233-4). They further held that, despite the managerial interlock between the parties, respondent was under no fiduciary obligation to accord plaintiff fair treatment in the tax transaction (R. 2221-3). The majority below reached these conclusions largely on the basis of federal tax law; partly also as a matter of state fiduciary law—although they failed to cite a single state court decision or even to determine which of the several state laws having contact with the case they deemed applicable (see

infra, p. 29). In order thus to affirm the District Court's decision upon theories not considered or adopted by that Court, the majority below made numerous totally new findings of fact (see *infra*, p. 24); and they held that such procedure was consonant with Rule 52(a) F. R. C. P. (R. 2236).

Judge Fee dissented (R. 2239). He likewise rejected the District Court's grounds (R. 2240-1), but held that the absence of fact findings by the District Court pertinent to the new grounds of decision was alone sufficient to require reversal (R. 2241-2, 2249-50). He further held that "plaintiff had no duty requiring it to file these returns" (R. 2243) and "no duty to apply the loss for the benefit of defendant" (R. 2251). Plaintiff, he held, "had a property right to file or refuse to file consolidated returns" (R. 2242); he denied that "the officers of plaintiff could give away [this] property right" (R. 2244) unless there "be findings that there was adequate consideration" (R. 2245). He concluded that "therefore the actual cash benefit obtained by defendant by use of losses of plaintiff might well be compensated by award of an equitable portion of the tax remission which the United States allowed on account thereof" (R. 2242-3).

Petitioners applied for rehearing en banc; but the same majority below struck the petition as unauthorized by law or practice (R. 2260). Judge Fee dissented because the decision of "this serious and important litigation", involving "novel statutory language affecting the fields of bankruptcy and taxes", should not rest upon the "three widely divergent views" expressed by three district judges (R. 2261).

The full bench of the Court below thereafter refused to consider rehearing en banc because the division had "authoritatively" denied it (R. 2288, 2296). Denman, Ch. J., dissented and voted to grant rehearing en banc (R. 2296, 2307).

4. *The decision of this Court.* Petitioners applied for certiorari both because of the substantive errors of the Court below and its "en banc" proceedings. This Court granted certiorari without qualification as to the issues to be reviewed (344 U. S. 809; see 345 U. S., at 250). The majority opinion of this Court (per Vinson, Ch. J.) did not, however, reach the substantive controversy; it vacated the order below striking the "en banc" petition because the Court below had failed to pass on the merits of that petition (345 U. S. 247). Mr. Justice Frankfurter concurred in a separate opinion.

Mr. Justice Jackson dissented on the ground that the "en banc" proceedings below should not be disturbed. Reaching thus the substantive issues, he held that the decision below should be reversed on the merits. Plaintiff, he held, had "the right, but no legal duty, under federal law to join in consolidated returns". The purpose of the statutes permitting plaintiff's loss to be offset against respondent's profits probably "was to provide salvage for the loser, not profit for one which sustained no loss". Plaintiff would have been morally and legally justified in bargaining for a fair share of the tax savings; and since the parties were "subject to considerable, if not complete, common control", plaintiff was "entitled to what fair arm's length bargaining would probably have yielded" (345 U. S., at 276-7).

5. *The decisions of the Court of Appeals after remand.* After amendment of its Rule 23 (R. 2353), the Court below, sitting en banc, referred the petition for rehearing en banc to the division which had originally heard the appeal (R. 2354). In a concurring opinion (R. 2359), Denman, Ch. J., intimated that he considered the case as "of such significance that it deserves the attention of the court en banc"; and he referred to the "very intricate" issues, the "stupendous" amount involved and this Court's previous grant of certiorari "on the merits as well as on the question of

rehearings en banc". Judge Pope dissented and voted to rehear the case en banc; he pointed to the "important" character of the litigation, the "novel point of law" involved, and the equal division of opinion between the four appellate judges who had considered the merits (R. 2356-7).

Thereupon two judges of the original panel below, in an opinion by Judge Healy, denied the petition for rehearing en banc (R. 2363). They did so without benefit of the views of Judge Fee who "did not participate in this determination" (R. 2373). In response, however, to Mr. Justice Jackson's opinion, the majority below proceeded to restate and expand their earlier grounds for dismissal, invoking principles of bankruptcy and federal judicial power. Thus they held that plaintiff's claim should be rejected because plaintiff was the former parent of the bankrupt respondent whose unpaid creditors had acquired their claims at a time when plaintiff owned and controlled respondent (R. 2368-9); because the final order in respondent's reorganization excluded all claims of its former stockholders (R. 2372); because plaintiff did not present its claim to the bankruptcy court (R. 2372); and because, in any event, the bankruptcy court would not have permitted plaintiff to bargain for a share in respondent's tax savings (R. 2370, 2372). Finally the majority below held, contrary to Mr. Justice Jackson, that it was beyond the judicial power of a federal constitutional court to determine "what fair arm's length bargaining would probably have yielded" (R. 2373).

Questions Presented

1. Are the federal tax statutes which permit, in consolidated tax returns, a parent corporation's stock loss to be offset against the subsidiary's profits, designed for the benefit of the parent or the subsidiary?

2. Under federal tax law, is a parent corporation with a tax loss entitled, but free of any duty, to join in con-

solidated tax returns with its profitable subsidiary in order to minimize the latter's taxes?

3. Does a Court of Appeals have power to make new findings of fact where the District Court has made none or has made contrary findings?

4. Did the Court below unduly depart from the accepted and usual course of appellate proceedings by deciding questions of state law (regarding the fiduciary relations and duties between the parties) without determining the applicable state law, although the case has important contacts with three state jurisdictions and the laws of each of the three states are contrary to the holdings below?

5. Where a transaction between two corporations is unilaterally advantageous to one of them although the two companies are, because of their interlocking managements, obligated to deal fairly with each other, is it beyond the judicial power of a federal constitutional court to determine what fair arm's length bargaining would probably have yielded?

6. Where a former subsidiary corporation and its reorganization trustees appropriate the former parent's tax credit, arising from the worthlessness of its stockholdings in the subsidiary, is the parent's claim to a fair share of the tax benefits precluded by the subsidiary's reorganization plan which eliminates the parent's stock interest in the subsidiary?

7. Is, upon these facts, the parent's claim precluded by the parent's failure to present it to the bankruptcy court, although the former subsidiary, upon emerging from the reorganization, assumed all obligations of its reorganization trustees?

Reasons for Granting the Writ

In this "serious and important litigation" (R. 2261), this Court's previous grant of certiorari (344 U. S. 809) was unqualified and unrestricted; the "en banc" question was to be reviewed only "among other things" (345 U. S., at 250). All of these other questions which were then deemed worthy of review are now presented again; and added to them are the new issues of bankruptcy law and federal judicial power raised by Judge Healy's recent opinion. This Court's previous allowance of the writ furnishes a persuasive precedent for this petition.

The federal questions presented are, indeed, not only "novel" and "intricate" (R. 2261, 2361), but of far-reaching importance; and on numerous points the decision below is in conflict with holdings of this Court and other Courts of Appeals.

1. Thus the majority below held that a parent (or former parent) with a large tax credit owes a legal duty to its profitable subsidiary to file consolidated returns in order to minimize the subsidiary's taxes (R. 2233-4, 2369). That is contrary not only to the holdings of Mr. Justice Jackson and Judge Fee, but in direct conflict with *Duke Power Co.* v. *Commissioner*, 44 F. 2d 543, 545 (C. C. A. 4, 1930), cert. den. 282 U. S. 903:

> "It [Congress] assumed that if there was that degree of affiliation which the law required [for consolidated returns] there was dominant control, and it gave to that dominant control [i.e., the parent] the right to make the choice [i.e., between consolidated and separate returns]. * * * If its [a corporation's] stockholders decide that its best interests require filing by it of a separate tax return, no provision of the law denies it this privilege * * *."

The Court below further held that the purpose of the tax laws was to confer a tax benefit on the profitable sub-

sidiary, respondent, rather than on the parent, plaintiff, which suffered the loss; hence respondent should retain the entire tax saving. Mr. Justice Jackson and Judge Fee held otherwise; and we shall show that the Court below misconstrued the purpose of the tax laws, contrary to the expressed Congressional intent and the rulings of this Court. The error below on this critical issue of federal law justifies the granting of certiorari; see *Phillips-Jones Corp.* v. *Parmley*, 302 U. S. 233 (1937).*

The tax statutes involved in these rulings below, I. R. C., §§ 23(g)(4) and 141, are in continued effect today as they have been since 1942 (contrary to a perhaps inadvertent statement in Mr. Justice Jackson's opinion). If the holding below should stand unreviewed, it is fair to predict a flood of litigations by subsidiaries or their stockholders against parent corporations for their failure to minimize the subsidiaries' taxes through consolidated returns. Indeed, at least one such litigation invoking the decision below as controlling authority is now pending in the New York Supreme Court (*Hirsh* v. *McAuliff*, N. Y. Co., No. 18648/1951). More than that: Whenever a parent corporation is hereafter faced with a choice of filing consolidated or separate returns—and that will happen each year in many thousands of instances—the decision below will cast a cloud of uncertainty and risk upon the management's freedom of choice. The decision below would destroy the parent corporation's privilege of choosing between consolidated and separate returns. If that be the law, it should at least be announced by this Court.

2. The Court below premised its judgment upon findings of fact made by it, not by the trial court. In the face of

* In that case, a stockholder of a dissolved corporation, having been forced to pay the corporation's taxes, asserted an equitable right to contribution against the other stockholders. The lower court denied contribution as contrary to the scheme of the tax laws. This Court granted certiorari because there was nothing in the tax laws to preclude the equitable remedy of contribution (302 U. S., at 235).

Judge Fee's criticism, the majority below insisted upon its right so to proceed (R. 2236), contrary to *Kupperman* v. *M. & J. Becker, Inc.*, 198 F. 2d 765, 770 (C. A. 2, 1952), and numerous other decisions of this Court and other Courts of Appeals. This highly prejudicial procedure, based on an unprecedented extension of the appellate powers of Courts of Appeals, requires review (Sup. Ct. Rule 38(5)(b)); see *Oil Shares, Inc.* v. *Commercial Trust Co.*, 304 U. S. 551 (1937), where this Court granted certiorari and simultaneously reversed and remanded to the District Court for appropriate findings.

3. The Court below also decided questions of fiduciary law without first determining the applicable state law, without citation or discussion of any local law whatever and in fact contrary thereto, all in disregard of the rule of *Griffin* v. *McCoach*, 313 U. S. 498, 503-4 (1941), and *Klaxon Co.* v. *Stentor E. M. Co.*, 313 U. S. 487 (1941).

4. The Court below refused to correct an inequitable transaction between fiduciary and cestui because it deemed a determination of what fair arm's length bargaining would probably have yielded to be beyond the judicial power of a federal constitutional court. Such doctrine would deal a death blow to the equitable powers which federal courts have wielded for more than a century; *Ewen* v. *Peoria & E. R. Co.*, 78 F. Supp. 312, 317 (D. C., S. D. N. Y., 1948, per Learned Hand, J.), cert. den. 336 U. S. 919. Review by this Court would seem imperative.

5. The Court below held that plaintiff's claim to a share in the tax savings produced by its tax credit would be contrary to the rights of respondent's unpaid creditors; and that the order of the bankruptcy court eliminating plaintiff's stock interest in respondent also eliminated plaintiff's right to compensation for the use of its tax credit. This meant, in effect, that the stockholder of a bankrupt corporation must not only subordinate its stock interest to the

claims of the creditors, but must surrender its own assets —here, its tax credit—for the satisfaction of the creditors in bankruptcy.

Equally untenable is the holding below that plaintiff forfeited its claim by not presenting it to the bankruptcy court. The claim arose from the appropriation of plaintiff's tax credit by respondent and its trustees. Even during respondent's reorganization plaintiff had the statutory right to assert this claim in any court of competent jurisdiction; § 66 of the (old) Judicial Code, 28 U. S. C. § 125 (old); *Texas & P. R. Co.* v. *Johnson,* 151 U. S. 81, 101 (1894). It had the same right after respondent emerged from reorganization and assumed all obligations of the trustees; *Chicago G. W. R. Co.* v. *Hulbert,* 205 Fed. 248, 250-1 (C. C. A. 8, 1913); *American Brake S. & F. Co.* v. *Pere Marquette R. Co.,* 263 Fed. 237, 240 (D. C., E. D. Mich., 1920).

In urging these reasons for certiorari, we are mindful of the need for brevity; we shall therefore present our arguments as succinctly as the problems in this "difficult and complicated litigation" (per Vinson, Ch. J.) will permit.

POINT I

The Court of Appeals erred in holding that the purpose of the tax law was to benefit respondent rather than plaintiff, and that plaintiff was under a duty to file consolidated returns for the sole benefit of respondent.

The Court below saw no reason why a tax saving "should inure to the benefit of the parent company or of the company which has sustained the loss that makes possible the tax saving" (R. 2232). On the contrary, it found plaintiff under a "duty not to attempt to appropriate to itself an advantage which the tax laws give the subsidiary" (R.

2369); so that plaintiff's officers acted properly in permitting "the tax advantage to fall where the tax laws ordained" (R. 2371), i.e., in respondent's pocket. These crucial holdings rest on a fundamental misconception of the purpose and operation of the tax statutes here involved.

1. When Congress, in 1942, allowed the worthlessness of stock in an affiliate as a deduction against ordinary income (§ 23(g)(4)), its purpose was obvious: Congress wished to mitigate the economic impact of such stock loss by the resulting tax saving. The decision below subverts this purpose; for the stock loss was suffered by plaintiff, while respondent was permitted to retain the tax saving. Since plaintiff and respondent were economic strangers, respondent's tax saving could not mitigate plaintiff's loss.

2. The holding below also flies in the face of uniform authority establishing that consolidated returns are designed for the benefit of the parent, not of the subsidiary. The rationale of consolidated returns

> "is the recognition of [the] common owner's right to set off against his gains in the one [corporation] his losses in the other [corporation] * * *".
>
> *Duke Power Co.* v. *Commissioner, supra* (44 F. 2d, at 545).

Or, as authoritatively stated in the *Report of the Senate Finance Committee,* 70th Cong., 1st Sess., S. R. 960, p. 14 (1928):

> "The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise. * * * The mere fact that by legal fiction several corporations owned by the same stockholders are separate entities should not obscure the fact that they are in reality one and the same business owned by the same individuals and operated as a unit. To refuse to recognize this situation and to require for tax purposes the breaking up of a single

> business into its constituent parts is just as unreasonable as to require a single corporation to report separately for tax purposes the gains from its sales department, from its manufacturing activities, from its investments, and from each and every one of its agencies."

To assure that the consolidated group is "in reality one and the same business", Congress required that the parent own 95% of the stock of its subsidiary, on the assumption that this would assure economic unity. See *Senate Committee Report, supra:*

> "Much of the misapprehension about consolidated returns will be removed when it is realized that it is only when the corporations are really but one corporation that the permission to file consolidated returns is given, and that no ultimate advantage under the tax laws really results. The present law permits the filing of consolidated returns only where one corporation owns at least 95 per cent of the stock of the other corporation or if a least 95 per cent of the stock of both corporations is owned by the same interest. The provision embodies the business man's conception of a practical state of facts."

And this Court in *Atlantic City E. Co.* v. *Commissioner,* 288 U. S. 152, 154 (1933):

> "The requirement of consolidated returns was 'based upon the principle of levying the tax according to the true net income and invested capital of *a single business enterprise,* even though the business is operated through more than one corporation.' Treasury Regulations No. 45, Art. 631." (Italics added.)

Thus the purpose of consolidated returns was simply to give the "common owner" (*Duke Power* case, *supra*) of an affiliated group of corporations the same tax benefits as the owner of a corporation operating through various departments. In both cases the intended beneficiary is neither the department nor the subsidiary, but the "common owner" of the business, i.e., the parent and its stock-

holders. Hence, neither the department nor the subsidiary, if it operates profitably, has any ground in its own person to seek a reduction of its taxes, even though another department or another subsidiary has sustained a loss. But the parent (the common owner) is permitted to do so because, in an economic sense, the profits and losses of each department or subsidiary are actually the profits and losses of the parent.

Hence the right to offset such losses and profits against each other in consolidated returns is the parent's right, created in its interest and for its benefit; any advantage flowing to the subsidiary is merely incidental and the fortuitous means by which the parent obtains its intended advantage.

The Court below, without even mentioning any of these authorities, reached the diametrically opposite conclusion that the tax laws intended to give all of the tax savings here involved to respondent (the subsidiary) and none to plaintiff (the parent). It predicated this result on a fragmentary analysis of two provisions of the tax law:

(a) The subsidiary, like the parent, may prevent the filing of consolidated returns by its refusal to consent thereto (R. 2230; I. R. C., § 141(a); Treas. Reg. 104, § 23.12). But the right of the parent, which alone can file consolidated returns, to refuse to do so is not comparable to the subsidiary's right of refusal. The parent's right is given in furtherance of the statutory intent that the parent, as the "common owner", should enjoy the benefits if it so desires. But the subsidiary is obviously not the "common owner" of the group; its consent is required only: (1) To assure uniform action by the entire affiliated group; and (2) To assure that the subsidiary is legally bound by the parent's election (otherwise the subsidiary might, e.g., deny its joint and several liability for the consolidated taxes, Treas. Reg. 104, § 23.15(a)). Since in the normal situation of economic unity between parent and subsidiary

—and that is the situation contemplated by the statute—the parent's power of control will enable it to guide the subsidiary, the requirement of the subsidiary's consent does not indicate that consolidated returns are intended for the benefit of the subsidiary.

(b) Equally unfounded is the reliance by the Court below on those provisions of the tax law which permit consolidated returns for a past period of affiliation although, at the time of filing, the affiliation has ended (R. 2230-1; see Treas. Reg. 104, § 23.12(e)). In these cases there exists no "economic unity" between the ex-parent and the ex-subsidiary at the time the consolidated returns are filed; and the ex-parent cannot derive any automatic benefit (through dividends or increased value of the ex-subsidiary's stock) from the tax savings of the former subsidiary. From these rather anomalous situations the Court below deduced that consolidated returns do not "require" economic unity and are not intended for the benefit of the parent (R. 2230-1).

The trouble with this argument is that it confuses the "requirements" of the statute with its "purpose". We never contended that the consolidated returns statute "requires" economic unity; we do contend that it "contemplates" economic unity; the authorities so hold. It is true enough that the statute requires no more than 95% stock ownership; but the statute makes this requirement on the theory that, by and large, corporations inter-connected by 95% stock ownership "are in reality one and the same business", "a single business" (*Senate Report, supra*). It is true that in a few anomalous situations the requirements of the statute can be fulfilled, although there is no economic unity; but the purpose of the statute nevertheless remains the same, namely, to grant relief to the parent as the common owner of the affiliated group.

The Court below thought that in those exceptional cases where the economic unity has been severed, "any benefits to the subsidiary obviously cannot inure to the parent"

(R. 2230). But that is not so. Since only the ex-parent can file consolidated returns, its self-interest will determine whether or not it should do so. The ex-subsidiary will likewise give or withhold its consent to consolidated returns according to its self-interest. In short, the filing or nonfiling of such returns and the sharing in the benefits therefrom may well be the subject of negotiation between ex-parent and ex-subsidiary and may well result in the sharing by both corporations. Moreover, where the parent voluntarily terminates the affiliation, it can assure itself the benefit of the subsequent filing of consolidated returns. Thus, if the parent sells its 95% stock interest in a subsidiary to a stranger knowing that its loss will, in a consolidated return, confer a $17,000,000 tax saving on the subsidiary, can it be doubted that this will be reflected in the price of the stock being sold?

By the same token, the purpose of the tax laws could not be automatically effected by the consolidated returns in the case at bar. Although plaintiff was the parent, its normal and automatic benefit from the tax saving of its subsidiary, the respondent, could not occur; for the shares of respondent, held by plaintiff, were merely pieces of paper representing neither equity nor right to dividends. Hence, the statutory purpose could be effected only in another fashion, namely, by an agreement between the parties allocating the resulting tax savings.

Agreements of this type are clearly envisaged by Treas. Reg. 104, § 23.15(a) and (d). They are a familiar device and have received administrative sanction. *Consolidated Electric & Gas Co.*, 15 S. E. C. 161 (1943); *Islands Gas & Electric Co.*, 13 S. E. C. 649 (1943); *Cities Service Co.*, 17 S. E. C. 839 (1944). In each of these cases affliated utility companies had filed consolidated returns; in each the company contributing a loss, and thereby reducing the taxes of its other affiliates, received compensation from them for the use of its tax credit; in each the S. E. C., pursuant to its Rule U-45(b)(6),* approved this arrangement

as fair and reasonable. In the case at bar, the need for a similar arrangement was much greater than in the three S. E. C. cases; for there, the consolidated group was an economic unit so that tax saving payments were merely a matter of expedience; whereas here, with the economic unity destroyed, such payments were a matter of necessity to achieve the purpose of the tax laws.

The Court below erred therefore in holding that the tax laws were intended to benefit respondent rather than plaintiff. And since this holding was the premise on which the Court below concluded that it was fair for respondent to retain all its tax savings produced by the use of plaintiff's tax credit, we submit that the conclusion must fall along with the premise.

POINT II

The Court of Appeals erred by making findings of fact where the District Court had made none, or had made contrary findings.

The Court below predicated plaintiff's duty to file consolidated returns not only upon the purpose of the tax laws, but upon the fiduciary relation between the parties. Its reasoning, however, is a tangled web of findings of fact which the Court—erroneously, we believe—made *de novo*, and of purported rules of fiduciary law contrary to all applicable local authorities. It will be helpful to show, first, the improper factual premises on which the Court below proceeded, and thereafter (Point III, *infra*) the legal conclusions it drew therefrom.

1. Of the numerous fact findings which the Court of Appeals made on its own authority—unsupported by, or

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* 17 C. F. R. (1949), § 250.45(b)(6); see *infra*, Appendix.

contrary to, the findings of the trial court—we cite but a few.

(a) The Court below found the record "barren of evidence" to support our contention that respondent dominated plaintiff in the tax transaction (R. 2235). This pivotal finding was contrary to the finding of the District Court (quoted *supra*, p. 9) that there was a "preponderance of the evidence" showing that respondent "had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant" (R. 264, 272). We have previously shown that the evidence amply supports this finding of the District Court (*supra*, pp. 6-8).

(b) The Court below found that plaintiff's officers, in filing consolidated returns, "were conforming with the policy and directions of the Corporation" (R. 2229). The District Court did not so find; and the record shows, without contradiction, that plaintiff's board of directors was not consulted about the filing of consolidated returns for the critical years (R. 1018).

(c) The Court below found that the interlock between the managements of plaintiff and respondent had been created by plaintiff (R. 2223, 2369). The District Court did not so find. During respondent's reorganization its personnel was, of course, appointed by the bankruptcy court; after the reorganization they were appointed by respondent's new stockholders and directors. Neither during nor after respondent's reorganization was plaintiff in a position to appoint respondent's personnel.

(d) The Court below found that, in each year from 1916 to 1942, the corporations forming the Western Pacific group had filed consolidated returns; and that in none of those years did the companies contributing a loss receive "tribute" for doing so (R. 2225, 2233, 2370-1). The Dis-

trict Court did not so find; * and the record establishes that in several instances an affiliate contributing a loss was indeed paid therefor (Price Waterhouse report, Def. Ex. 40, not printed pursuant to order, R. 2176).

(e) The Court below found that the firm of Whitman Ransom Coulson & Goetz were "independent tax experts" (R. 2226). The District Court, far from finding this firm "independent", referred to them as "the tax attorneys for defendant" (R. 261, 265); and their bias for respondent is established by the uncontradicted evidence (*supra*, p. 7). Similarly, in discussing Mr. Nicodemus, the Court below selected only the evidence purportedly showing his loyalty to plaintiff (R. 2370), but completely passed over the undisputed fact that Nicodemus was paid solely by respondent and its trustees and was instructed by them to protect respondent's interest in the tax matter (*supra*, p. 7).

We refrain from citing additional instances. Each of the findings of the Court of Appeals which we have listed was important to its decision; each was unsupported by any finding of the District Court; each was contrary to the clear evidence.

2. In adopting this course, the majority below did not act casually or inadvertently, but purported to lay down a broad principle of appellate power and procedure. In the face of Judge Fee's detailed criticism (R. 2239, 2241-2, 2249-50), the majority below held that findings of fact are merely "intended to aid appellate courts", and that they "are not a jurisdictional requirement of appeal which this court may not waive" (R. 2236).

The holding below, we submit, was contrary to Rule 52(a) and (b) F. R. C. P. which entrusts the task of fact

* The District Court did find that the consolidated taxes were allocated among the various subsidiary companies having taxable income in proportion to the amount of such taxable income (R. 261). But the District Court did not find that there were no payments to other companies contributing a loss.

finding to the trial court, not the appellate court. It was also contrary to the holdings of this Court and other Courts of Appeals. Thus the court in *Kupperman* v. *M. & J. Becker, Inc.*, 198 F. 2d 765, 770 (C. A. 2, 1952), although finding the evidence "abundantly clear", nevertheless remanded because "We cannot * * * make the necessary finding since as an appellate tribunal we are without the power to do so". Accord: *Kelley* v. *Everglades Drainage District*, 319 U. S. 415, 421-2 (1943); *McClure* v. *O. Henry T. & A. Co.*, 184 F. 2d 636, 639 (C. A. 7, 1950).

The majority below invoked three decisions as supporting its power to make new findings (R. 2236). None of them is in point. Indeed in *Mayo* v. *Lakeland H. C. Co.*, 309 U. S. 310 (1940), this Court reversed the lower court because of the insufficiency of the District Court's fact findings; it held that "fair compliance with Rule 52(a)" was "of the highest importance to a proper review" (p. 316); and it remanded with directions that "any action taken by the court shall be upon findings of fact and conclusions founded upon the evidence, in accordance with Rule 52(a)" (p. 319).

In *Goodacre* v. *Panagopoulos*, 110 F. 2d 716 (App. D. C., 1940), the trial court had embodied its findings in a memorandum opinion instead of making "separate findings" of fact; the Court of Appeals merely held that it need not reverse "for a mere formal failure to comply with the rule" (p. 718).

In *Hurwitz* v. *Hurwitz*, 136 F. 2d 796 (App. D. C., 1943), the court did hold that findings of fact by the trial court are "not a jurisdictional requirement of appeal which this court may not waive" and that their purpose is merely "to aid appellate courts in reviewing the decision below" (p. 799). Whether or not the *Hurwitz* decision was correct when it was made in 1943 need not be debated. It certainly has lost its vitality since the 1946 amendment of the Federal Rules of Civil Procedure. The *Committee Note of 1946 to Rule 52(a)* states:

> "Findings of fact aid in the process of judgment and in defining for future cases the precise limitations of the issues and the determination thereon. Thus they not only aid the appellate court on review (*Hurwitz* v. *Hurwitz* (App. D. C. 1943), 136 F. 2d 796), but they are an important factor in the proper application of the doctrines of res judicata and estoppel by judgment."

The *Hurwitz* rule that findings are merely designed to aid the appellate court was thus rejected; and with the elimination of that premise, the conclusion that an appellate court may waive findings of the trial court and make its own findings must equally fall. The weight to be accorded to the Committee Notes is, of course, well recognized; *Mississippi Pub. Co.* v. *Murphree,* 326 U. S. 438, 444 (1946).

We submit, therefore, that the Court of Appeals erred in making its own findings; and the Court compounded the error by making findings which were contrary to those of the District Court and contrary to the evidence.

POINT III

The Court of Appeals erred in determining the fiduciary relations and duties between the parties without determining the applicable local law and, indeed, contrary to local law.

The majority below held plaintiff to be respondent's fiduciary, merely because of its ownership of respondent's worthless stock. It rejected our contention that *respondent* owed plaintiff the fiduciary duty of fair treatment in these tax transactions; interlocking management, said the Court, absent domination and control, does not give rise to a fiduciary relation. The Court then assumed, *arguendo,* that respondent was obligated to deal "fairly" with plaintiff; but it held that there was fairness because plaintiff had suffered no damage.

1. The Court below erred in not determining the applicable state law.

The Court below recognized that it "must look to the law of corporations to determine whether the subsidiary [respondent] stood in a fiduciary relation to Corporation [plaintiff]" (R. 2221-2). But the Court failed to determine which state law it deemed applicable. There was need to do so since plaintiff is a Delaware corporation with its office in New York; respondent is a California corporation likewise maintaining an office in New York; and the consolidated tax returns were prepared, signed and filed in New York (R. 6, 12, 643, 659, 661, 666). Contrary to the precept of *Klaxon Co.* v. *Stentor E. M. Co.*, 313 U. S. 487 (1941), the Court omitted to consult the applicable conflict of laws rules of California.

Even more grievous is the Court's total failure to cite a single New York, Delaware or California decision in support of its rulings. It preferred to formulate its own views of the mutual fiduciary duties of affiliated corporations. This Court condemned such procedure in *Griffin* v. *McCoach*, 313 U. S. 498, 503-4 (1941). The lower court there had pronounced its view of the applicable state law without the citation of any authorities. This Court held:

> "But this is something to be decided according to Texas decisions to none of which the opinion refers. [Citing cases.] The decision must be reversed and remanded to the Circuit Court of Appeals for determination of the law of Texas as applied to the circumstances of this case."

2. The Court below erred in holding plaintiff to be respondent's fiduciary.

The majority below so held solely because plaintiff "was the sole owner of the subsidiary's capital stock" (R. 2234). Clear beyond cavil is the contrary rule of law: Naked stock ownership creates no fiduciary duty unless the parent dominates or controls the subsidiary. *Southern Pacific*

Co. v. *Bogert,* 250 U. S. 483, 492 (1919); *Blaustein* v. *Pan American P. & T. Co.,* 263 App. Div. 97, 119 (1941), aff'd 293 N. Y. 281 (1944); *Allied Chemical & Dye Corp.* v. *Steel & Tube Co.,* 14 Del. Ch. 1, 12-13, 120 Atl. 486 (1923); *Title Ins. & T. Co.* v. *California Dev. Co.,* 171 Cal. 173, 205-6, 152 Pac. 542 (1915); 13 *Fletcher, Corporations* (1943), § 5811, pp. 127-8. The Court below conceded that during the critical period respondent "was no longer controlled by Corporation [plaintiff] but by the trustees appointed by the bankruptcy court" (R. 2223). The holding below that plaintiff was the fiduciary of respondent was thus wholly unfounded.

3. The Court below erred in holding that respondent owed plaintiff no fiduciary duty of fair treatment in the tax transactions.

Having rejected—improperly, we say—the District Court's finding that respondent controlled plaintiff, the Court below had to deal with the effects of the managerial interlock between plaintiff and respondent. The Court conceded that "there obviously existed an interlocking management" (R. 2223); but it held, nevertheless, as a matter of law, that the "mere fact of officers and directors in common does not create such a fiduciary relationship" (R. 2222). No authority is cited for this amazing proposition.

The contrary, we submit, is a rule of universal application. *Geddes* v. *Anaconda Copper Mining Co.,* 254 U. S. 590, 599 (1921), states the classical and most frequently cited formulation of the doctrine:

> "The relation of directors to corporations is of such fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation; and where the fairness of such transactions is challenged, the burden is upon those who would maintain them to show their entire fairness; * * *. This court has been consistently emphatic in the

application of this rule, which, it has declared, is founded in soundest morality and, we now add, in the soundest business policy."

The rule is the same in New York, in Delaware, in California and, indeed, throughout the land. *Chelrob* v. *Barrett,* 293 N. Y. 442, 460-2, 57 N. E. 2d 825 (1944); *Keenan* v. *Eshleman,* 23 Del. Ch. 234, 243-4, 2 Atl. 2d 904 (S. Ct., 1938); *Title Ins. & T. Co.* v. *California Dev. Co.,* 171 Cal. 173, 205-6, 152 Pac. 542 (1915); *Mayflower Hotel S. P. C.* v. *Mayflower Hotel Corp.,* 173 F. 2d 416, 418-423 (App. D. C., 1949, with numerous references).

The rule rests on "the ancient precept against serving two masters", *Pepper* v. *Litton,* 308 U. S. 295, 311 (1939), a principle as old as Holy Writ, "infallible and hallowed", *Alexander* v. *Theleman,* 69 F. 2d 610, 613 (C. C. A. 10, 1934). Just as there is danger that a director dealing with his corporation will favor his personal interest, so in transactions between interlocking corporations "the danger to be avoided is that a director or group of directors, common to two corporations, may, for reasons of self-interest, favor one of the entities in its dealings with the other"; *Mayflower* case, *supra,* 173 F. 2d, at 420. Hence courts impose "the most careful scrutiny of transactions between the corporations represented by common directors, to the end that, in the absence of arm's-length bargaining, the scales may not, even through mistake or inadvertence, be unfairly tipped to one side or the other"; *Chelrob* v. *Barrett, supra,* 293 N. Y., at 461.

The Court below totally ignored all of these authorities; and it failed to cite any state authorities of its own.* We

* The only state authorities cited below (R. 2371) are *Shelley* v. *Board of Trade,* 87 Cal. App. 344, 264 Pac. 403 (1927), and *McMillan* v. *O'Brien,* 219 Cal. 775, 29 P. 2d 183 (1934). Neither of them involved any fiduciary law or relations. The courts held that an executed voluntary transfer of property by an individual is valid without consideration. That may be true where, as in those cases, the parties dealt at arm's-length. It is obviously not true where the common officers of two corporations cause one to make a $17,000,000 gift to the other.

submit therefore that the Court below erred in holding respondent to be free of any fiduciary duty to deal fairly with plaintiff in the tax transactions.

4. The Court below erred in holding that respondent accorded plaintiff fair treatment.

The Court below held that, even if respondent was obligated to deal fairly with plaintiff, it had not breached this duty. Fairness, said the Court, required no more than that respondent should not sacrifice plaintiff's interests to its own (R. 2232). And there was no such "sacrifice" because plaintiff, poor and without income, could not use its tax credit to create tax savings for itself (R. 2232-3).

Plaintiff's alleged inability to use its tax credit is just another "fact" found by the Court of Appeals without any supporting finding of the District Court. Although plaintiff had no income of its own, it had other means of utilizing its tax credit; see *Alprosa Watch Corp.* v. *Commissioner*, 11 T. C. 240 (1948).

But wholly apart from these possibilities, the very fact that plaintiff's tax credit was useful to respondent made it a valuable asset of plaintiff. Plaintiff and respondent each had an essential ingredient for achieving a tax benefit. They joined their resources to produce the tax benefit; but only one, the fiduciary, respondent, retained all the profit while plaintiff, its cestui, received none. Can this result possibly be called fair dealing by a fiduciary with its cestui?

In the words of Mr. Justice Jackson:

> "It may seem anomalous at first glance that a sustained loss can be realized upon as an asset. But it is not the loss; it is the right to use the loss as an offset that is valuable. The market for it is restricted, of course, but this detracts nothing from its value to one in a position to utilize it. * * * I know of no moral or legal obligation to give away any legal opportunity or advantage just because its owner cannot utilize it himself."

The argument of the Court below that "after the transaction Corporation was in exactly the same position that it was in before" (R. 2233), implies that plaintiff cannot recover because it did not suffer actual injury. The Court does not reveal upon which local law it predicates the necessity of injury. The law is well settled that a fiduciary dealing unfairly cannot escape an accounting on the ground that the cestui suffered no detriment. Thus in *Leslie* v. *Commercial Nat. Bank in Shreveport,* 28 F. Supp. 927, 933 (D. C., W. D. La., 1939), aff'd sub nom. *Commercial Nat. Bank in Shreveport* v. *Parsons,* 144 F. 2d 231, 236-7 (C. C. A. 5, 1944), the fiduciary was held liable "regardless of whether the principal had suffered injury or not". In *Fleishhacker* v. *Blum,* 109 F. 2d 543, 546 (C. C. A. 9, 1940), a bank officer was held accountable for the breach of his fiduciary duty "even though the bank has suffered no damage". And see *Restatement, Restitution* (1937) § 1, Comment (e), pp. 14-15; § 197, Comment (c), pp. 809-810.

We submit that respondent was obligated to accord plaintiff fair treatment in the tax transaction; and that respondent acted less than fair by retaining all and allowing plaintiff none of the resulting benefits.

POINT IV

The Court of Appeals erred in holding that it is beyond the judicial power of a constitutional Court to determine what fair arm's length bargaining would probably have yielded plaintiff.

Mr. Justice Jackson held that "plaintiff is entitled to what fair arm's length bargaining would probably have yielded". The Court below rejected this holding because "Bargaining presupposes negotiations" and "Such activity is a matter of business administration, and is not a judicial function" within the province of a "constitutional court" (R. 2373).

The short answer is that constitutional courts have, since time immemorial, performed this very function. In *Chelrob* v. *Barrett, supra* (293 N. Y. 442), and in *Marian* v. *Mariani,* 276 App. Div. 205, 93 N. Y. S. 2d 370 (1949), one affiliated corporation had sold its property to another at an inadequate price; the court had no trouble in determining the amount of the "fair" price and in requiring the purchaser to pay it to the seller. In *Ewen* v. *Peoria & E. R. Co.,* 78 F. Supp. 312 (D. C., S. D. N. Y., 1948), cert. den. 336 U. S. 919, the problem was the "fair" division of income and expenses between two jointly operated railroads feeding traffic to each other, both companies being under identical management. Judge Learned Hand held that the court "should fix the terms of any transactions between the two as though each had in fact exerted its bargaining power against the other at arm's length" (p. 317); and he showed how, in a difficult situation, this requirement can be met.

The holding below, we submit, presents a novel and unjustified limitation upon the equitable powers of a "constitutional court". The holding should not be permitted to stand as a precedent without first being reviewed by this Court.

POINT V

The Court of Appeals erred in holding that plaintiff's claim is precluded by the order of the bankruptcy court eliminating plaintiff's stock interest in respondent or by plaintiff's failure to present its claim to the bankruptcy court.

1. Respondent's reorganization plan (233 I. C. C. 409) eliminated plaintiff's stock interest in respondent; and the final order of the bankruptcy court accordingly provided that the assets of the reorganized respondent were to be free and clear of all claims of its former stockholders (R. 2014). Both the District Court and the Court of Appeals

held that these provisions were incompatible with plaintiff's present claim to a share in respondent's tax savings (R. 272-5, 2372). For a "saving" in taxes, it was held, actually means earnings not paid out to the Government; plaintiff's claim is therefore a demand for a share of respondent's earnings; and the assertion by plaintiff of such a claim "is a circuitous way of obtaining something in the nature of equity or value for its ownership [of respondent's stock], rejected in the reorganization plan" (R. 272).

The fallacy of this reasoning lies in the confusion of what plaintiff is entitled to get by virtue of its stock ownership in respondent; and what it is entitled to get by virtue of respondent's use of plaintiff's tax credit.

It is perfectly true that respondent's reorganization plan precluded plaintiff from any share in respondent's assets or earnings based upon plaintiff's ownership of stock in respondent. That stock was wiped out; and plaintiff was left, at this point, without right or interest in respondent's assets and earnings.

But after this was done—indeed because it was done—plaintiff had a tax credit. The tax credit belonged to plaintiff, not to respondent or its creditors. Respondent's reorganization plan did not and could not provide that plaintiff's tax credit must be made available to respondent or its creditors or its bankruptcy trustees.*

Plaintiff did make its tax credit available to respondent; respondent caused it to do so. This was a new transaction not contemplated by the reorganization plan. Plaintiff's claim stems from this new transaction; by no stretch of argument may it be viewed as based on its previous stock ownership in respondent.

It follows that plaintiff's present claim, based upon the use of its tax credit by respondent, does not contravene

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* Apart from other obstacles, the plan could not so provide because it was formulated in 1939 whereas the amendment of I. R. C., § 23(g)(4), was not enacted until 1942.

the provisions of the reorganization plan eliminating plaintiff's stock interest in respondent.

The Court below repeatedly emphasized that respondent's creditors did not receive full payment in the reorganization (R. 2234-5, 2368-9). Suppose so.* But plaintiff was not a guarantor of respondent's debts. It was, of course, required to subordinate its claims as a stockholder to the claims of the creditors; and that was done. But no bankruptcy law—indeed, no law whatever—required plaintiff to surrender its own asset, i.e., its tax credit, for the payment of respondent's creditors.

The Court below further held that plaintiff could not have bargained for a share of respondent's tax savings because the bankruptcy court would not have permitted it to do so (R. 2370, 2372). The argument begs the question. If plaintiff had been obligated to file consolidated returns without sharing in the tax savings, the bankruptcy court would indeed properly have vetoed any bargain. But if, as we contend, plaintiff was under no such duty and was, in Mr. Justice Jackson's words, "entitled to what fair arm's length bargaining probably would have yielded", then it is idle to speculate that the bankruptcy court might improperly have objected to a fair bargain.

We submit that, contrary to the Courts below, respondent's reorganization plan and the final order of the bankruptcy court do not preclude plaintiff's claim.

2. The Court below further held that plaintiff's claim is barred because it was not presented to the bankruptcy court (R. 2372). But why should it have been so presented? The consolidated tax returns for the year 1944 and the refund claim for the year 1942 were filed in 1945, long after respondent had emerged from reorganization in December, 1944. So far as plaintiff's claim rests on these post-

* The District Court made no such finding, and the question is in serious dispute.

reorganization events, it was obviously beyond the province of the bankruptcy court.

The consolidated tax returns for the year 1943 present a somewhat different picture. They were filed in July 1944; at that time respondent was still in the hands of its reorganization trustees. So far as plaintiff's claim rests upon the filing of these tax returns, it was therefore originally directed against the trustees. But at the end of the reorganization in December, 1944, respondent assumed all obligations of the trustees (R. 1711-3); and that included their liability for the claim at bar.

Even during the reorganization, plaintiff would have had the statutory privilege of asserting its claim (then directed against the trustees) in any court of competent jurisdiction, wholly outside the bankruptcy proceedings; § 66 of the (old) Judicial Code, 28 U. S. C. § 125 (old). That statute (now 28 U. S. C. § 959) was applicable to railroad reorganizations under § 77 of the Bankruptcy Act; *Thompson* v. *Texas Mexican R. Co.*, 328 U. S. 134, 138 (1946). It "abrogated the rule that a receiver [or trustee] could not be sued without leave of the court appointing him, and gave the citizen the unconditional right to bring his action in the local courts"; *Gableman* v. *Peoria, D. & E. R. Co.*, 179 U. S. 335, 338 (1900); *Texas & P. R. Co.* v. *Johnson*, 151 U. S. 81, 101 (1894). It follows *a fortiori* that now—after the end of the reorganization, the discharge of the trustees and the assumption of their liabilities by respondent—plaintiff is likewise free to assert its claim in any appropriate forum of its choice, without any requirement to present it to the bankruptcy court. *Chicago G. W. R. Co.* v. *Hulbert*, 205 Fed. 248, 250-1 (C. C. A. 8, 1913); *American Brake S. & F. Co.* v. *Pere Marquette R. Co.*, 263 Fed. 237, 240 (D. C., E. D. Mich., 1920); *Lassiter* v. *Norfolk S. R. Co.*, 163 N. C. 19, 21-22, 79 S. E. 264 (1913).

CONCLUSION

This "serious and important litigation" has traveled a most unusual road. The District Court, after a thirteen-day trial and upon a voluminous record (R. 264), reached its conclusion on a ground not urged or briefed by any of the parties. The majority below affirmed; but it rejected the major ground advanced by the District Court; instead, it substituted its own grounds; to do so it sought in effect to constitute itself as the trial court. The majority opinions below are the result: Shot through with improper and erroneous findings of fact, misconstruction of the federal tax and bankruptcy laws, improper and erroneous application of the rules of fiduciary law, lack of regard for local law—all intertwined and inseparable grounds for the decision below. One judge below dissented; and three judges below (Denman, Pope and Fee) thought that the case should be reheard en banc.

When the case came to this Court, the only Justice who reached the merits likewise voted to reverse. The result thus is that, of the four appellate judges passing on the merits, two voted for affirmance and two for reversal.

Thus, the cleavage among the several judges who have so far heard this case has been deep, vehement and fundamental. They have voiced several conflicting points of view, each of broad significance not only for this litigation, but for countless future controversies.

Undoubtedly, these conflicts and errors reflect the difficulty of the issues involved and the large amount at stake. Landmark cases, such as the instant one, beget such deep-seated differences. They likewise require and justify hearing by this Court to set those conflicts at rest authoritatively and finally.

For all the reasons stated herein, we respectfully urge that substantial justice for the petitioners and for the thousands of stockholders of plaintiff justifies the granting of this petition for certiorari.

Dated: November 9, 1953.

Respectfully submitted,

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APPENDIX

Text of Statutes and Regulations cited

Internal Revenue Code

§ 23. *Deductions from gross income.* In computing net income there shall be allowed as deductions: * * *

(g) Capital losses.

(1) Limitation. Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

(2) Securities becoming worthless: If any securities (as defined in paragraph (3) of this subsection) become worthless during the taxable year and are capital assets, the loss resulting therefrom shall, for the purposes of this chapter, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

(3) Definition of securities. As used in paragraph (2) of this subsection the term "securities" means (A) shares of stock in a corporation, and (B) rights to subscribe for or to receive such shares.

(4) Stock in affiliated corporation. For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset. For the purposes of this paragraph a corporation shall be deemed to be affiliated with the taxpayer only if:

(A) at least 95 per centum of each class of its stock is owned directly by the taxpayer; and

(B) more than 90 per centum of the aggregate of its gross incomes for all taxable years has been from sources other than royalties, rents (except rents derived from rental of properties to employees of the company in the ordinary course of its operating business), dividends, interest (except interest received on deferred purchase price

of operating assets sold), annuities, or gains from sales or exchanges of stocks and securities; and

(C) the taxpayer is a domestic corporation.

§ 122. *Net operating loss deduction.*

(a) Definition of net operating loss. As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) Amount of carry-back and carry-over.

(1) Net operating loss carry-back. If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d), (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2) Net operating loss carry-over. If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d), (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net op-

erating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d), (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year).

§ 141. *Consolidated returns.*

(a) Privilege to file consolidated income and excess-profits-tax returns. An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making consolidated income and excess-profits-tax returns for the taxable year in lieu of separate returns. The making of consolidated returns shall be upon the condition that the affiliated group shall make both a consolidated income-tax return and a consolidated excess-profits-tax return for the taxable year, and that all corporations which at any time during the taxable year have been members of the affiliated group making a consolidated income-tax return consent to all the consolidated income- and excess-profits-tax regulations prescribed under subsection (b) prior to the last day prescribed by law for the filing of such return. The making of a consolidated income-tax return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated returns shall include the income of such corporation for such part of the year as it is a member of the affiliated group. In the case of a corporation which is not a member of the affiliated group after March 31, 1942, of the last taxable year of such group which begins before April 1, 1942, such corporation shall not be considered a member of the affiliated group for consolidated income-tax-return purposes for such

year but shall be considered a member of such group for consolidated excess-profits-tax-return purposes for such year, and the consent required in the case of such corporation shall relate only to the consolidated excess-profits-tax regulations.

(b) Regulations. The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making consolidated income- and excess-profits-tax returns and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income- and excess-profits-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability. Such regulations shall prescribe the amount of the net operating loss deduction of each member of the group which is attributable to a deduction allowed for a taxable year beginning in 1941 on account of property considered as destroyed or seized under section 127 (relating to war losses), and the allowance of the amount so prescribed as a deduction in computing the net income of the group shall not be limited by the amount of the net income of such member.

(c) Computation and payment of tax. In any case in which consolidated income-tax and excess-profits-tax returns are made or are required to be made, the taxes shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the last day prescribed by law for the filing of such returns; except that the tax imposed under section 15 or section 204 shall be increased by 2 per centum of the consolidated corporation surtax net income of the affiliated group of includible corporations. Only one specific exemption of $10,000 provided in section 710(b) (1) shall be allowed for the entire affiliated group of corpora-

tions for the purposes of the tax imposed by Subchapter E of Chapter 2.

(d) Definition of "affiliated group". As used in this section, an "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

(1) Stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

(2) The common parent corporation owns directly stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of at least one of the other includible corporations.

As used in this subsection, the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(e) Definition of "includible corporation". As used in this section, the term "includible corporation" means any corporation except—

(1) Corporations exempt under section 101 from the tax imposed by this chapter.

(2) Insurance companies subject to taxation under section 201 or 207.

(3) Foreign corporations.

(4) Corporations entitled to the benefits of section 251, by reason of receiving a large percentage of their income from sources within possessions of the United States.

(5) Corporations organized under the China Trade Act, 1922.

(6) Regulated investment companies subject to tax under Supplement Q.

(7) Any corporation described in section 725(a), or in section 727 (e), (g), or (h) (without regard to the exception in the initial clause of section 727) but not including such a corporation which has made and filed a consent, for the taxable year or any prior taxable year beginning after December 31, 1943, to be treated as an includible corporation. Such consent shall be made and filed at such time and in such manner as may be prescribed by the Commissioner with the approval of the Secretary.

(f) Includible insurance companies. Despite the provisions of paragraph (2) of subsection (e), two or more domestic insurance companies each of which is subject to taxation under the same section of this chapter shall be considered as includible corporations for the purpose of the application of subsection (d) to such insurance companies alone.

(g) Subsidiary formed to comply with foreign law. In the case of a domestic corporation owning or controlling, directly or indirectly, 100 per centum of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for the purpose of this chapter and of Subchapter E of Chapter 2 as a domestic corporation.

(h) Suspension of running of statute of limitations. If a notice under section 272(a) in respect of a deficiency for any taxable year is mailed to a corporation, the suspension of the running of the statute of limitations, provided in section 277, shall apply in the case of corporations with

which such corporation made a consolidated return for such taxable year.

(i) Allocation of income and deductions. For allocation of income and deductions of related trades or businesses, see section 45.

Treasury Regulation 104, 26 C. F. R. (1949), § 23

§ 23.12 *Making consolidated return and filing other forms.*

(a) *Consolidated return made by common parent corporation.* A consolidated return shall be made on Form 1120 by the common parent corporation for the affiliated group. Such return shall be filed at the time and in the office of the collector of the district prescribed for the filing of a separate return by such corporation.

(b) *Authorizations and consents.* (1) Each subsidiary must prepare duplicate originals of Form 1122, consenting to these regulations and authorizing the common parent corporation to make a consolidated return on its behalf for the taxable year and authorizing the common parent (or, in the event of its failure, the Commissioner or the collector) to make a consolidated return on its behalf (as long as it remains a member of the affiliated group), for each year thereafter for which under § 23.11 (a), the making of a consolidated return is required. One of such forms as prepared by each subsidiary shall be attached to the consolidated return, as a part thereof; and the other shall be filed, at or before the time the consolidated return is filed, in the office of the collector for the district prescribed for the filing of a separate return by such subsidiary. No such consent can be withdrawn or revoked at any time after the consolidated return is filed.

* * *

(4) A corporation which consents to be treated as an includible corporation for a taxable year beginning after December 31, 1943, shall be treated as an includible corporation for all subsequent years, regardless of whether the affiliated group of which such corporation is a member during such subsequent years is the same as the affiliated group of which such corporation was a member when such consent was filed. No consent to be treated as an includible corporation under section 141(e)(7) can be withdrawn or revoked at any time after the consolidated return is filed for the first taxable year for which the consent is filed.

(b) * * *

§ 23.15 *Liability for tax.*

(a) *Several liability of members of affiliated group.* Except as provided in paragraph (*b*), the common parent corporation and each subsidiary, a member of the affiliated group during any part of a consolidated return period, shall be severally liable for the tax (including any deficiency in respect thereof) computed upon the consolidated net income of the group.

(b) *Liability of a corporation in bankruptcy or receivership.* If, at the time of filing a consolidated return, one or more, but not all, of the members of the affiliated group are in bankruptcy under the laws of the United States or in receivership in any court of the United States or of any State, Territory, or the District of Columbia, then the liability under paragraph (*a*) of each such member of the group with respect to the period covered by such return shall not exceed such portion of the consolidated tax liability for such period as the several corporations included in the consolidated return may, subject to the approval of the Commissioner, agree upon, or, in the absence of such an agreement, an amount equal to its liability for such year computed as if a separate return had been filed.

(c) * * *

(d) *Effect of intercompany agreements.* Any agreement entered into by one or more members of the affiliated group with any other members of such group or with any other person shall in no case have the effect of reducing the liability prescribed under this section.

(e) * * *

§ 23.16 *Common parent corporation agent for subsidiaries.*

(a) *Scope of agency of common parent corporation.* Except as provided in paragraphs (b) and (c) of this section:

(1) The common parent corporation shall be for all purposes, in respect of the tax for the taxable year for which a consolidated return is made or is required, the sole agent, duly authorized to act in its own name in all matters relating to such tax, for each corporation which during any part of such year was a member of the affiliated group. The corporations, other than the common parent, shall not have authority to act for or to represent themselves in any such matter. For example, all correspondence will be carried on directly with the common parent; notices of deficiencies will be mailed only to the common parent, and the mailing to the common parent shall be considered as a mailing to each such corporation; notice and demand for payment of taxes will be given only to the common parent, and such notice and demand shall be considered as a notice and demand to each such corporation; the common parent will file petitions and conduct proceedings before the Board of Tax Appeals, and any such petition shall be considered as having also been filed by each such corporation; the common parent will file claims for refund or credit; refunds will be made directly to and in the name of the common parent and will discharge any liability of the Government in respect thereof to any such corporation; and the common

parent in its name will give waivers, give bonds, and execute closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise, or any other document so executed, shall be considered as having also been given or executed by each such corporation. Notwithstanding the provisions of this paragraph, however, any notice of deficiency, in respect of the tax for a consolidated return period, will name each corporation which was a member of the affiliated group during any part of such period, and any assessment (whether of the original tax or of a deficiency) will be made in the name of each such corporation (but a failure to include the name of any such corporation will not affect the validity of the notice of deficiency or the assessment as to the other corporations); any notice and demand for payment will name each corporation which was a member of the affiliated group during any part of such period (but a failure to include the name of any such corporation will not affect the validity of the notice and demand as to the other corporations); and any distraint (or warrant in respect thereof), any levy (or notice in respect thereof), any notice of a lien, or any other proceeding to collect the amount of any assessment, after the assessment has been made, will name the corporation from which such collection is to be made. The provisions of this paragraph shall apply whether or not a consolidated return is made for any subsequent year, and whether or not one or more subsidiaries have become or have ceased to be members of the group at any time. Notwithstanding the provisions of this paragraph, the Commissioner may, if he deems it advisable, deal directly with any member of the group in respect of its liability, in which event such member shall have full authority to act for itself.

(b) * * *

Rule 52 of the Federal Rules of Civil Procedure

Findings by the Court.

(a) *Effect.* In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; * * *. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. * * * If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. * * *

(b) *Amendment.* Upon motion of a party made not later than ten days after entry of judgment the court may amend its findings or make additional findings and may amend the judgment accordingly. * * *

§ 66 of the Judicial Code, 28 U. S. C., § 125

(The following is the text in force prior to September 1, 1948)

§ 125. (Judicial Code, section 66.) Suits against receiver. Every receiver or manager of any property appointed by any court of the United States may be sued in respect of any act or transaction of his in carrying on the business connected with such property, without the previous leave of the court in which such receiver or manager was appointed; but such suit shall be subject to the general equity jurisdiction of the court in which such manager or receiver was appointed so far as the same may be necessary to the ends of justice.

Securities and Exchange Commission Rule U-45, 17 C. F. R. (1949), § 250.45

§ 250.45 *Loans, extensions of credit, donations and capital contributions to associate companies.*

(a) *General provision.*—No registered holding company or subsidiary company shall, directly or indirectly, lend or in any manner extend its credit to nor indemnify, nor make any donation or capital contribution to, any company in the same holding company system, except pursuant to a declaration notifying the Commission of the proposed transaction, which has become effective in accordance with the procedure specified in Rule U-23, and pursuant to the order of the Commission with respect to such declaration under the applicable provisions of the Act.

(b) *Exceptions.*—The following transactions shall be exempt from the declaration requirements of this rule:

* * * * * *

(6) A loan or extension of credit or an agreement of indemnity arising out of a consolidated tax return filed by a holding company (or other parent company) and its subsidiaries: *Provided,* That the top company in the group assumes primary responsibility for the payment of any tax liability involved, subject to the right to contribution from the several members of the group in an amount not exceeding as to any company that percentage of the sum of the normal tax, surtax, and excess profits tax on a consolidated basis which the sum of the normal tax, surtax and excess profits tax of such company if paid on a separate return basis is of the aggregate amount of normal, surtax and excess profits taxes of the individual companies based upon separate returns. In each instance the amount of excess profits tax shall be computed less the amount of the post-war refund. In computing each company's tax on a separate return basis, allowance shall be made for

loss carry-over and other adjustments as if the company had always filed its tax return on a separate return basis. The amount of post-war refund bonds which the consolidated group will acquire (under section 780 of the Internal Revenue Code) and the liability therefor shall be allocated to the several members of the group in the ratio that the post-war refund bonds each company would acquire on a separate return basis bears to the sum of the post-war refund bonds which all of the companies would acquire on the basis of separate tax returns.

SUPREME COURT, U.S.
FILED
NOV 24 1953
HAROLD B. WILLEY, C

In the Supreme Court of the United States

OCTOBER TERM, 1953

THE WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. duP. BAYARD, Receiver,

Petitioners,

vs.

THE WESTERN PACIFIC RAILROAD COMPANY, et al.,

Respondents.

No. 441

MEREDITH H. MATHEWS, HENRY CROCKER and J. S. FARLEY & CO., INC.,

Petitioners,

vs.

THE WESTERN PACIFIC RAILROAD COMPANY, et al.,

Respondents.

No. 443

On Petitions for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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In the Supreme Court of the United States

OCTOBER TERM, 1953

THE WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. DUP. BAYARD, Receiver, *Petitioners,* vs. THE WESTERN PACIFIC RAILROAD COMPANY, et al., *Respondents.*	No. 441
MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE & CO., INC., *Petitioners,* vs. THE WESTERN PACIFIC RAILROAD COMPANY, et al., *Respondents.*	No. 463

On Petitions for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

Brief for Respondents in Opposition

These petitions ask virtually unprecedented certiorari relief. They ask this Court again to review the identical record which was before it in Nos. 150 and 160 of last term save only that the Court of Appeals has again considered petitioners' claims and again concluded they are without merit. Not once in recent years and seldom if ever in its history has this Court, at succeeding terms and on the same record, issued writs of certiorari in the same case to hear the same questions. There is no reason to do so now.

The Court heard the case on the merits in December, 1952. It left undisturbed the judgment that petitioners take nothing but vacated the order below denying the applications for rehearing, directed the Court of Appeals to establish appropriate procedures for considering petitions for rehearing and rehearing in banc, and instructed that court to allow petitioners to take advantage of the new procedure. All this has been done. The rules below have been amended in accordance with the mandate of this Court; under the amended rules the Court of Appeals in banc has referred the rehearing applications to the Division; the Division has given careful consideration to the suggestions for rehearing and rehearing in banc and denied both. In respondents' judgment this litigation should now be at an end.

OPINIONS BELOW

The District Court opinion is reported at 85 F. Supp. 868. The Court of Appeals opinion on the merits is reported at 197 F.2d 994, and on the rehearing problem at 197 F.2d 1012. This Court's opinion is reported at 345 U.S. 247. The amendment by the Court of Appeals of its rule in accordance with the mandate of this Court appears at 205 F.2d 374, where the in banc order of the Court of Appeals referring the rehearing application to the Division is reported. The opinion of the Division denying the rehearing applications is reported at 206 F.2d 495.

JURISDICTION

The order of the Court of Appeals under the amended rules denying petitioners' application for rehearing and rehearing in banc was entered August 20, 1953. The petitions for writ of certiorari were filed October 26 and

November 12, 1953. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

The case no longer presents a problem of Court of Appeals rehearing procedure.[1] With that single exception the questions presented are the identical questions presented last term, that is:

1. Does a holding company, whose stock interest in an operating railroad company has been lost by judicial decree confirming a plan for reorganizing the railroad company, have a right in equity to be paid, at the expense of unpaid secured creditors of such subsidiary, for the reduction of the taxes of the reorganization trustees of the railroad company resulting from the entry of the holding company's loss as a deduction in consolidated federal income tax returns, in repudiation of the holding company's own practice in tax dealings with its former subsidiary, and notwithstanding that the holding company suffered no loss or damage through the entry of its loss in the tax returns?

2. Has such claim of the holding company been lost through failure to present it to the bankruptcy court in the course of the reorganization proceeding?

STATUTES INVOLVED

The consolidated returns were filed under Section 141 of the Internal Revenue Code. The stock loss deduction is authorized by Section 23(g)(4) of the Code, enacted in October, 1942.

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[1]See also *Bradley Mining Co. v. Boice*, No. 321, October Term, 1953, certiorari denied Nov. 9, 1953.

STATEMENT

The petitions distort the facts, returning to the implications of wrongdoing repeatedly urged and repeatedly rejected, most recently in the Court of Appeals opinion of August 20, 1953 (R. 2370):

> "It must be borne in mind that all the transactions were open and aboveboard and were carried on in plain sight of all concerned; that there was no fraud, deceit, unfairness, or overreaching; that the consolidated return was filed by appellant's president in accordance with the practice of previous years; that the general counsel for appellant, who is of counsel for that party in this proceeding, recommended the employment of the tax counsel who conceived the idea of including appellant's stock loss in the consolidated return and called the attention of appellee's predecessor to the tax advantage."

The District Court reached the same conclusion (R. 274, 971), a conclusion confirmed by the Court of Appeals in its first opinion (R. 2219, 2226-7, 2234-5). There is no dissent on this point (345 U.S. 277). The tax transactions were honest, open and candid. This has been settled by the courts and it is demonstrated by the record.[2]

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[2]The petitioner Corporation charges that the tax result was accomplished "by respondent's taking over and managing petitioner's affairs for respondent's own benefit" (p. 5); but the court below said "The filing of these returns was in exact conformity with the practice followed since 1916" (R. 2224). The Corporation says that tax counsel for the trustees prepared "all the operative documents" (p. 5); the fact is that most of the tax returns were prepared in the office of the Corporation itself (R. 829-30, 844-6, 1258-9, 1414). The Corporation says that its president, Mr. Curry, was "a sort of figurehead" (p. 6); the trial court, *after* hearing him testify, described Mr. Curry as "a perfectly competent man, independent, and probably a pretty good railroad man" (R. 785). The Corporation claims that its board

From 1916 until April 30, 1944 the petitioner, The Western Pacific Railroad Corporation (the "Corporation"), owned all the stock of the pre-reorganization The Western Pacific Railroad Company, the predecessor in interest of respondent, the reorganized "Company". In 1935 the Corporation directed its subsidiary to file a petition for reorganization (230 I.C.C. 61) whereupon the railroad properties were transferred to reorganization trustees who owned and operated them until December 31, 1944, a period

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members were clerks (p. 6); the board members included, however, Thomas M. Schumacher, for many years chief executive of the Western Pacific system (R. 1719, 1724), characterized by counsel for petitioners as a person "of great ability and great honesty of character" (R. 993); Willis D. Wood, a past governor of the New York Stock Exchange (R. 1122); A. Perry Osborn, an experienced New York lawyer who, until his death, was of counsel for petitioners in this case and who came to the board at the suggestion of the Chase National Bank (p. 990); and H. Brua Campbell, a member of the New York law firm of Pierce & Greer, the firm representing the Corporation in this action. The Corporation says that the trial court concluded that the trustees controlled the Corporation directors (p. 35); but the Corporation itself in answering the complaint in intervention denied all allegations of domination and control (R. 156); the Corporation officers denied all such charges (R. 743-4, 1011-16, 1046, 1126, 1136, 1143); and the trial court refused to make a finding of domination (R. 462-86, 276).

The petitioning interveners charge that the respondent avoided its tax obligations "by causing plaintiff to file consolidated returns" (p. 4); the court below, however, pointed out that the returns were filed "in exact conformity with the practice followed since 1916" (R. 2224). The petitioners repeat the charge that Mr. Curry, the Corporation president, was a mere "signing officer" (p. 6); the trial court characterized Mr. Curry as "independent" and "competent" (R. 785). The petitioners complain of pay to the Corporation officers by the trustees (p. 7); when the trustees undertook to pay all the New York expense in the latter part of the trusteeship, they did so only because the Corporation, finding itself without funds (R. 789-90, 1243-4), repeatedly requested that this arrangement be made (R. 790, 1244, 1257, 1839, 1845, 1852-3). The petitioners say the Corporation lacked tax information (p. 7); but the Corporation president and its lawyer received an oral report from tax counsel (R. 839, 1079-80), a written report (Ex. P 50, R. 1757), the annual reports of the trustees discussing tax

of more than nine years. The plan of reorganization formulated by the Interstate Commerce Commission (230 I.C.C. 61, 233 I.C.C. 409) limited the first mortgage bonds of the reorganized company to $10,000,000 to be exchanged for trustees' certificates (Par. O, 233 I.C.C. 451). The old first mortgage bondholders received income bonds, preferred and common stock. Junior secured interests were not paid by at least $3,495,900, plus interest (R. 1220-2, 2021), and the new securities issued to the old bondholders have not had, generally speaking, the value assigned to them in the plan.[3] The plan declared the stock interest in and all un-

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problems (Ex. 20 B, 20 C, R. 511-14, 1279) and notice of the hearing held by the reorganization court to review the tax situation and establish a tax reserve (R. 1991, 703, 1085), and a copy of the order establishing the reserve (R. 1216, 1991, 703, 1085). Petitioners assert that the 1943 returns were prepared by respondent's employees (p. 8); they were in fact prepared in the Corporation office (R. 1414, 829-30, 844-6, 1258-9) by the same personnel who had prepared the returns in prior years (R. 1414-7) and signed by the Corporation president (R. 663-6, 831, 837), who had handled tax matters for the group for many years (R. 841-5) and who, thoroughly understanding the tax situation, had written to the Corporation's lawyer explaining it (Ex. In. 5, R. 2125). Petitioners say that the Corporation's president signed the returns "without consulting plaintiff's board of directors" (p. 8), but it had never been the practice for the board to see or approve the returns (R. 846). The petitioners assert that the settlement with the Government was made "without advance approval by plaintiff's board" (p. 8); they neglect to point out that the Corporation had received notice of the proposed settlement two months before it was accomplished (R. 669, 1788), that during that period the directors had considered the matter at length and decided against withdrawal of the offer of settlement (R. 1644-5), that they approved the settlement by formal action (R. 1103, 1644-5) and that the Corporation had been emphatic in saying both before and after this litigation began that tax counsel handled the tax transactions in a thoroughly satisfactory fashion (R. 1103-4).

[3]The plan assigned a value of $100 per share to the preferred stock and $57 and $62 per share to the common stock (233 I.C.C. 452) of the reorganized company. The price range of these stocks

secured claims against the debtor to be valueless (Par. P. (5), 233 I.C.C. 452). On March 15, 1943 the reorganization plan was approved by this Court (*Ecker v. Western Pacific R. Corp.*, 318 U.S. 448, affirming *In re Western Pacific R. Co.*, 34 F. Supp. 493). In October, 1943 the plan was confirmed by the District Court (R. 496, 1674); on December 31, 1944 the railroad properties were returned to the reorganized company, the respondent here (R. 499, 1711, 36-108); and the reorganization proceeding was closed by a final order dated March 28, 1946 (R. 1219, 2013).

Each year beginning in 1918 the Corporation prepared, signed and filed consolidated tax returns for itself and all group members (R. 1258-9; R. 843-4). Each year the tax owing under the returns was allocated among the group members according to the formula universally accepted, that is: the consolidated return tax was distributed pro rata to those members of the group having taxable incomes in direct proportion to their several taxable incomes. No tax was allocated to a "loss company" and no payment was made to any such company for taxes "saved" through the entry of its loss in the returns (R. 1262).

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on the New York stock exchange is as follows for the periods indicated:

Year	Common		Preferred	
	High	Low	High	Low
1945	57⅛	30½	92	64¼
1946	56½	27	101	71
1947	42¼	26½	90	65
1948	36½	25½	74½	58¼
1949	30	20	70¼	53¾
1950	55	28	89	64½
1951	58¾	46½	94¼	84¼
1952	64½	46½	98	89
*1953	67⅜	46½	99¼	90

*To Oct. 31, 1953.

This practice continued during the reorganization. The group had no taxable income from 1935 through 1941 and no tax was paid (R. 1552, 2040). In 1942 and subsequent years the trustees had substantial income which, if consolidated returns were filed (Regs. 104, Sec. 33.31(f)), could be offset in part by loss carry-overs and carry-backs belonging to the trustees (R. 591, 921, 1759). For this and other reasons consolidated returns were obviously advantageous and such returns were filed for 1942, 1943 and the first four months of 1944, during which the group affiliation continued.

The 1942 returns reported a tax of $4,201,821.54 (R. 172). With insignificant exceptions the tax resulted from trustee income and it was paid by the trustees from the bankruptcy estate (R. 169, 824, 826, 1306-7). The order confirming the plan of reorganization (R. 496, 1674) became final in November, 1943 and the Corporation's stock loss was, for tax purposes, then realized (R. 606-8, 1409-10). Since this loss plus trustee carry-overs greatly exceeded trustee income the 1943 returns reported a large operating loss and no tax owing (R. 172). Under the appropriate provisions of the Internal Revenue Code, the loss was carried over to the first four months of 1944 and no tax was reported for that period. In March, 1945 the Corporation, as agent for the affiliated group (Regs. 104, Sec. 23.12), filed a claim for refund of the 1942 taxes paid by the trustees. The refund claim was based on a carry-back of a part of the 1943 loss (R. 492, 1654).

The tax liability of the Western Pacific Group for 1942, 1943 and the first four months of 1944, was settled with the Government in August, 1947. The 1942 refund claim for $4,201,821.54 was denied and the returns were accepted as filed (R. 168-173).

During the years here in question, 1942, 1943 and 1944, the Corporation had no income and the 1943 loss had, therefore, no tax utility to the Corporation itself.

Beginning on December 11, 1939, and continuously thereafter, the Corporation was a party to the reorganization proceeding (R. 1217, 1994, 1600-3). The Corporation at no time suggested, however, that it had a claim against the trustees on account of tax savings—and this even though the last of the tax returns was filed July 15, 1945 (Ex. P. 5A/B, R. 492), nine months before the reorganization proceeding closed on March 28, 1946 (R. 1219, 2013) and even though one important reason, expressly stated, why the reorganization proceeding remained open after the properties were returned to the reorganized company was to permit the bankruptcy court to hear and consider claims against its trustees (R. 62).

The complaint in this action was filed October 10, 1946 (R. 5, 11), six months after the final decree of the bankruptcy court. As a practical matter, however, the litigation began when the petitioning stockholders acquired a small portion of the preferred stock of the Corporation at nominal prices (R. 1147-55, 1642-3, 1905-7, 2102) and in June, 1946, brought a stockholders' suit in New York against the officers of the Corporation (R. 147) charging, among other things, failure to protect the Corporation in connection with the consolidated returns. Three months later this action was filed (R. 5, 11) and in due course the stockholders intervened (R. 121-55).

The District Court, following elaborate discovery proceedings and an extensive trial, gave judgment for respondents (R. 258, 320). On appeal the judgment was affirmed, Judge Fee dissenting (R. 2214). Petitions for rehearing and

for rehearing in banc were filed with the Court of Appeals. The application for rehearing was denied (R. 2259-60). The petition for rehearing in banc was stricken as being unauthorized by law or by the rules of court (R. 2260). A petition to file a motion to reinstate the petition for rehearing in banc (R. 2267) was denied by six of the seven Circuit Judges, Judge Denman dissenting (R. 2288, 2313). Petitions for certiorari were filed with this Court and granted (344 U.S. 809). The case was briefed and argued at length. In due course this Court filed its opinions and issued its mandate leaving undisturbed the judgment for respondents on the merits but vacating the orders denying the petitions for rehearing (R. 2321). Upon return of the mandate the Court of Appeals amended its rules (R. 2353) and the requests for rehearing and rehearing in banc were renewed (R. 2325, 2339). The court in banc referred these requests to the Division (R. 2354) where they were there denied (R. 2363). Petitioners now ask for writs of certiorari to the Court of Appeals.

ARGUMENT

The question now is this. Should the Court twice hear this case? Should it hear again on the identical record the identical arguments heard at length last term? Should it permit petitioners to prolong this litigation, now in the courts seven years, by allowing them once more to present claims already presented in three courts and nowhere approved? Respondents think not. Defendants as well as plaintiffs have their rights. When a claim has been fully considered and duly and regularly rejected the defendant is entitled to go free of it. Respondents respectfully ask the Court to bring this litigation to an end.

In the judgment of respondents the request for a second certiorari is both an unreasonable insistence on a meritless claim and an unreasonable demand on the time of the Court. Last term in this case the Court read lengthy briefs, heard three hours of argument relating almost entirely to the merits of the claim and prepared extensive opinions. The opinion announced for the Court was confined entirely to procedural matters. Apparently, therefore, the Court either found no error in the record other than procedural error (now corrected) or concluded that the case, procedural matters aside, is one for decision by the Court of Appeals. In either event, these applications for certiorari should be denied. If the decision below is right, it requires no further review; if the case is properly for Court of Appeals decision, that decision has been made.

1. This Is Not a Case for a Second Certiorari.

For this Court to consider and if need be correct the rehearing procedures of the Court of Appeals is, of course, an appropriate exercise of its supervisory powers over the affairs of the Federal courts. But this has now been accomplished and in no other aspect is this case appropriate for certiorari. The facts, according to Chief Justice Vinson, are "complicated" and "unique" (345 U.S. 249), a characterization with which petitioners agree (the Corporation's 1952 Reply Brief, p. 2). According to Mr. Justice Jackson, the case "is so unique that it is without precedent and it is likely to be without progeny" (345 U.S. 275). Federal jurisdiction rests here solely on diversity (345 U.S. 249, 275) and the claim depends on common law theories of unjust enrichment (345 U.S. 249, 276). It is difficult to see why

this Court should undertake to write unjust enrichment law for the courts of California or New York. On more than one occasion the Court has refused to determine state law which could more appropriately be determined elsewhere. See, for example, *Gardner v. New Jersey*, 329 U.S. 565 (1947); *Busby v. Electrical Utilities Employees Union*, 323 U.S. 72 (1944).

The case, it is true, deals with taxes and tax problems, but under the special circumstances here presented this is a reason against, rather than for, Supreme Court consideration. Tax law as written here is law for the entire country. It seems evident, therefore, that if possible this Court should make its tax decisions in cases in which the Government participates. Petitioners, for example, contend that the use of a loss in a consolidated return, with the consequent saving of taxes, entitles the loss company to compensation. The Treasury has proceeded on the contrary assumption in allocating consolidated excess profits tax to provide deductions from normal tax net income (T.D. 5086), in determining earnings and profits available for dividends (I.T. 3637, I.T. 4085) and in computing the basis upon which a parent holds stock of a subsidiary (Regs. 104, Sec. 23.34(c)). If petitioners are right the Treasury is wrong. But the Treasury is not here. In similar fashion, if petitioners are right the Securities and Exchange Commission is wrong. Its Rule U-45(b)(6) requires public utility holding companies to follow the identical practice which petitioners attack.[4] But the Commission, like the

[4]The S.E.C. has recently asked for comment on a proposed modification to Rule U-45(b)(6) but the suggested change does not support petitioners' position. The proposed modification would distribute the consolidated tax, as heretofore, to the group members

Treasury, is not before the Court. Congress will not permit the courts to hear an attack upon its legislation in the absence of the Attorney General (28 U.S.C. 2284(2)). A comparable policy is appropriate here. One of the important reasons why this Court controls its own docket is to avoid the very situation which petitioners seek to create.

These considerations against a new certiorari—the demand on the Court's time twice to hear the same case, the fact that the law problems are problems of local law, the absence of the Treasury and S.E.C.—are genuine and important. They are not necessarily conclusive, however, and cases could undoubtedly arise in which they would not be controlling. But this is not such a case.

2. The Petitions Present No Valid Reason for a Second Certiorari.

The petitions quarrel with the phrasing of the opinions below but they present no reason for believing that this case (with the rehearing problem solved) meets certiorari requirements. A "unique" case (345 U.S. 249, 275) does not, almost by definition, present an "important question" (Rule 38(5)(b)). A claim based upon local law of unjust enrichment (345 U.S. 249, 276) raises no federal question (Rule 38(5)(b)) and petitioners did not invoke the federal question jurisdiction of the District Court (R. 6, 124). A case "without precedent" (345 U.S. 275) can hardly conflict with other decisions of the state or federal courts (Rule 38(5)(b)) and the fact is that the decision below is in strict

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having income and, as heretofore, without tax saving payments; in computing the income position of each company, however, dividends received from group members would be excluded. It is reported that two Federal commissions and eight state commissions have recorded opposition to any change whatever in the rule. 52 *Public Utilities Fortnightly* 473.

accordance with the practice of the business community (*S.E.C.* Accounting Release No. 53, dated Nov. 16, 1945) and all the relevant rulings and precedents. See, for the rule of the *S.E.C.*, Rule U-45(b)(6); for the *Treasury* rulings, T.D. 5086, I.T. 3637, I.T. 4085; for the views of the *Federal Trade Commission*, Sen. Doc. No. 92, Part 72-A, 70th Cong. 1st Sess., p. 478; for the views of the *Interstate Commerce Commission*, the decisions in *Central of Georgia Railway Co. Reorganization*, 252 I.C.C. 587, 600 (1942) and *St. Louis-San Francisco Railway Co. Reorganization*, 257 I.C.C. 399, 410 (1944); and for the views of *Congress*, the *Hearings before the Senate Committee on Interstate Commerce*, 74th Cong., 1st Sess. on S. 1725, p. 255. Where, then, is the ground for certiorari?

The petitions seek to create that ground by a contention that the Court of Appeals decided tax law questions and decided them erroneously. The argument is that the court below held that the Revenue Acts obligated the Corporation to join in the returns. There was no such ruling. The court said (R. 2229-30):

> "The Code and Regulations recognize that the benefit of the consolidated returns is for all corporations in the group. Any subsidiary in the group, as well as the parent, may prevent the filing of consolidated returns if the filing is detrimental or contrary to the interests of such corporation."

There is here no suggestion that the *Revenue Acts* create an obligation to sign the returns. The obligation existed, but it arose, as the court clearly held, out of the bankruptcy proceeding and the relation of the Corporation to the other group members and their creditors (R. 2234-5):

"The Corporation was sole owner of the subsidiary's capital stock. As such it was under a duty to deal fairly with the subsidiary having full regard for the interests of the creditors and holders of other securities. *Consolidated Rock Co. v. DuBois,* 312 U.S. 510, 522. It owed a duty not to require its subsidiary to forego a legitimate tax saving and could not bargain to perform its duty.

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A tax return is an historical document relating to the past. This return related to a period when the affiliation existed. All fiduciary duties with respect to matters arising during the relationship continue during the winding up period, and are 'as sacred and inviolable after as before the expiration of its term.' It would be ridiculous to say that a fiduciary who performs an act winding up matters which relate to the affiliation period may exact payment merely because the relationship has technically terminated. If Corporation had required tribute as a condition of its cooperation, then it would have been acting with less than the required standard of fairness to the subsidiary's creditors. Equity will not permit a recovery as a substitute for a bargain which would have been unfair."

Here is a plain statement that the source of the obligation to sign the returns was the relation of the parties and not the Revenue Acts. On rehearing the court affirmed its position in that respect and said (R. 2369):

"In our decision we discussed the obligations of a holding company to its subsidiary and creditors, and its duty not to attempt to appropriate to itself an advantage which the tax laws give the subsidiary." (Emphasis supplied).

The petitions complain of the phrase "an advantage which the tax laws give the subsidiary." The meaning, however, is clear: that the consolidated returns naturally operated to reduce the taxes of group members having income or, to use the language of the court, "the tax laws give the subsidiary" an advantage. All the arguments of petitioners are based on this tax advantage. The court did no more than to acknowledge what petitioners insist upon. Petitioners take a single phrase from two long opinions, distort its meaning, twist it into a ruling of the court in complete disregard of the true basis of decision and then ask review of this imaginary ruling. The fact that petitioners must go so far to find an argument is some measure of the merit of these petitions.

The other grounds offered in support of the writ are equally unsubstantial. The Corporation claims there has been some abuse of the decision in *Ecker v. Western Pacific Railroad Corporation*, 318 U.S. 448 (1943), presumably on the theory that the reorganization plan was too harsh. This is both untrue and irrelevant. In this if in no other railroad reorganization, the new securities have not had, generally speaking, the values assigned to them by the plan and in any event the purpose of this proceeding is not to review the *Ecker* decision. The Corporation says, too, that the court below unduly restricted the judicial power of the Federal Courts—this because the opinion on rehearing emphasizes the difficulty of making an ex post facto bargain for parties in a fiduciary relationship, when there was nothing to sell and when everyone concerned was subject to the jurisdiction of the reorganization court. These difficulties are not unreal, particularly since this Court has held that

in a reorganization proceeding nothing will be paid for "strategic position" or "sheer nuisance value." *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 131 (1939). There are complaints in the petitions about findings of fact by the Court of Appeals and the interveners add objections to the conclusions expressed on fiduciary obligations and the failure of the opinions to cite state decisions. The fact is that the Court of Appeals found no new facts. The opinions, as in every other case, recite the facts the record discloses, facts petitioners have characterized as "few", "simple" and "wholly undisputed" (the Corporation's District Court Brief p. 1). This can hardly be error. Moreover, the opinions fully disclose the basis of decision and the fiduciary duties of the parties were correctly stated. There is no reason here for certiorari.

Certainly there is no reason here for a second certiorari. The phrase about the "advantage which the tax laws give the subsidiary" to which petitioners object was in the record last term (R. 2234); the same argument was then made about a perversion of the purposes of Congress in permitting a subsidiary to obtain an advantage through consolidated returns; the same contentions were advanced about findings of fact by the Court of Appeals; the same objections were offered to the decision below as to the fiduciary obligation of the parties. Each of these points has been extensively briefed (The Corporation's 1952 Brief pp. 62, 146, 76) and heard at length in this Court. Petitioners have nothing new to say and there is no reason to hear them again.

3. There Has Been No Injustice to Petitioners.

Petitioners complain at length about the work of the courts below. They are less articulate in explaining why there is merit in their claim and why, if the claim has merit, they have been unable anywhere to obtain a judgment. The arguments advanced by petitioners in support of their position are speculative, conflicting, novel and unsupported by any precedent.[5] The objections to the claim, on the other hand, are clear, firm, numerous and, as the opinions below explain, insurmountable. No one denies, for example, that what was done in connection with the 1942-4 Western Pacific taxes was exactly what had been done by the Western Pacific group for twenty-five years under the direction of the Corporation itself (R. 1258-9), exactly what the Treasury expects will be done (T.D. 5086, I.T. 3637, I.T. 3692), exactly what the S.E.C. requires public utilities to do (Rule U-45(b)(6)), exactly what the Federal Trade Commission (Sen. Doc. No. 92, Part 72-A, 70th Cong., 1st Sess., p. 478)

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[5]The arguments of petitioners *assume*, rather than prove, their position. Petitioners stress the dual employment of the Corporation officers, an alleged fiduciary duty in favor of the Corporation and allegations that the Corporation was dominated by the trustees. These arguments, as the courts below pointed out, beg the question. Duality, domination and fiduciary obligation are important only if the Corporation failed to obtain something to which it was entitled. The courts below have concluded, and correctly, that the Corporation was entitled to nothing as "tribute" from the other group members. Since the Corporation lost nothing to which it was entitled, it makes no real difference how or by whom the tax transactions were handled. The fact is, however, that the trustees did not dominate the Corporation and all the Corporation officers so testified (R. 743-4, 1011-6, 1046, 1126, 1136, 1143). The fiduciary duty between the parties did not run to the Corporation but from it in favor of the other group members and their creditors. *Consolidated Rock Co. v. DuBois*, 312 U.S. 510 (1941). And the so-called duality was the normal arrangement in an affiliated group, an arrangement made by the Corporation itself. (R. 1839, 1845, 1852-3, 1738).

and the Congressional committees (Hrgs. on S. 1725, 74th Cong., 1st Sess., p. 255) have said was right, and exactly what the American business community has always thought proper (S.E.C. Release No. 53, dated Nov. 16, 1945). No one denies that this claim is a speculation brought to life by the intervening stockholders who purchased their shares at nominal prices (R. 1147-55, 1642-3, 1905-7, 2102) and obviously for litigating purposes. No one denies that no effort was made to present the claim in the reorganization proceeding (R. 2372), although the very purpose of that proceeding was to bar all unapproved claims (R. 274). No one can deny that if the claim were allowed the Corporation would be preferring itself to the unpaid creditors of its bankrupt subsidiary, creditors to whom it owed fiduciary duties. Nor can anyone deny that, if the question were reached and before the claim could be allowed, petitioners would have to overcome the bar of the reorganization and the statute of limitations. These circumstances hardly suggest that the decision below was erroneous.

Although petitioners are unwilling to say it plainly, their argument is not and never has been more than this: "Without us there could have been no tax saving; therefore we must be paid." This is a simple syllogism and it has failed not because the courts below have been unable to understand it; but rather because they have understood it only too well.

Petitioners to the contrary notwithstanding, the law of unjust enrichment does not say that everyone who participates in a transaction must inevitably take some share of the proceeds. It all depends. In a case such as this, where the claim for compensation is made ex post facto and with

respect to a closed transaction honestly and openly conducted, the presumption is against rather than in favor of the claim. Petitioners, as the courts below have discovered, have not succeeded in overcoming this presumption. Moreover, compensation is never awarded except where the enrichment is unjust, that is, where property has been transferred or a service provided in the reasonable expectation that payment would be made. Here there was no expectation of payment; no property transferred; no service provided. And since the Corporation had no income against which the loss could be offset, the use of the loss in the tax returns resulted in no disadvantage or damage to the Corporation.

In the final analysis the tax saving resulted from the operation of the tax laws on the determination by the bankruptcy court and this Court that the stock of the operating company owned by the Corporation was worthless, a determination, incidentally, which the Corporation vigorously opposed. With that conclusion of record, there was nothing between the trustees and the tax result here achieved except the signature of all the members of the Western Pacific group, including the Corporation, to the consolidated returns. In strict accordance with twenty-five years of past practice the consolidated returns were signed and filed. The Corporation did nothing to bring about the tax result except to provide a signature. The courts below are emphatic in the conclusion that the Corporation, for reasons of good management, for reasons of fiduciary obligation to its subsidiary and its unpaid creditors, and for reasons of equity arising out of the bankruptcy proceeding, could not set a price on this signature. Moreover, the returns were needed in order to preserve the trustees' credits and carryovers.

To compel the trustees to pay unnecessary taxes would have been a gross abuse of the Corporation's management and bankruptcy obligations, an abuse which the reorganization court would never for a moment have tolerated.

Petitioners talk about fairness, but no one need be deceived. Petitioners here seek a judgment of several million dollars not because they have any claim to the money but because they say they could have compelled the trustees to make an equal or larger payment in taxes to the United States. No court has ever approved and respondents think it unlikely that any court will ever approve any such claim. Courts listen to rights, not to threats.[6] The Corporation had no rights. It had nothing to sell. It wants pay not because of what it did for the trustees but because of the harm it might have done them. The courts below wisely and correctly concluded that the special circumstances of this case provide special reasons for following, rather than abandoning, the uniform and approved practice as to the allocation of rights and duties under consolidated returns.

The judgment below follows the accepted practice of the business community, the settled practice of the Western Pacific group and the judgment of every informed person who has considered the problem of rights and duties under consolidated returns. That judgment can hardly be said, therefore, to be in error. Since there has been no injustice

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[6]From the outset, there has been in this case a suggestion that a bargain should have been exacted by the Corporation or, as counsel for the interveners put it on the motion for intervention, "* * * what the directors should have done, may it please the Court, is to have forced an apportionment by agreement of the tax loss from the subsidiary companies before permitting the use of the loss belonging to holding without any benefit to its stockholders." (R. 332). The court below characterized this position as a demand for "tribute" (R. 2233-5).

to petitioners, since this case presents none of the traditional reasons for certiorari relief, and since, in any event, the case has already once received the careful attention of this Court, it seems clear that the pending petitions should be denied. Litigation, as the saying goes, should have a place to end.

Dated: November 23, 1953.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 441

WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS J. duP. BAYARD, RECEIVER,
Petitioners,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD.,
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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 441

WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. duP. BAYARD, RECEIVER,
Petitioners,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD.,
Respondents.

Reply Brief in Support of Petition for Certiorari

The refrain of respondents' brief is that it is somehow unfair to ask the Court to review the case, the record being the same as in No. 150, 1952 Term, and that it would be unprecedented for the Court to do so. Respondent proceeds as if petitioner were seeking a rehearing of an adverse decision by this Court!

When this Court reversed No. 150, it did not approve the judgment below on the merits. On the contrary, that judgment was disapproved by the only Justice who expressed an opinion on the merits—Mr. Justice Jackson. This Court felt that the en banc issue warranted a reversal and thought it unnecessary to go further. But it not only vacated the order below denying leave to reinstate the petition for rehearing en banc, it also vacated the denial of a

rehearing, and thereby it opened up the judgment for later review in the event a rehearing should again be denied (Mandate, R. 2322). In remanding the cause it envisaged the possibility, if not the probability, that a rehearing en banc would be granted, that the whole court below would then decide the cause for petitioner, or, if it should sustain the panel, would at least give this Court the benefit of a clearer and sounder exposition of reasons, and thus in either event simplify this Court's task. It is not unusual for this Court to remand so that it may obtain the considered view of a lower court, and thereafter to grant certiorari again (Cf. *U. S. v. Ballard,* 322 U.S. 78, 88, and *Ballard v. U. S.,* 329 U.S. 187).

Instead, the consequences of the remand were abortive. The court below, en banc, declined to give consideration either to the merits of the cause or to the merits of granting a rehearing. And the panel, truncated by the non-participation of one of its members, the one who had voted for petitioner before, declined to reconsider the case. The questions that this Court judged important enough to warrant a writ of certiorari last year, but which it did not thereafter reach, are thus again presented—this time aggravated and added to by the latest opinion of the truncated panel rendered on denying rehearing again.

Apart from the foregoing, the gist of the respondent's opposition may be placed in three categories.

I.

THERE ARE IMPORTANT FEDERAL QUESTIONS

Respondent asserts that a judgment determining the legal consequences attaching to the filing of consolidated tax returns under federal tax laws raises no question of federal concern. That is little short of amazing. If that were not a federal question, it would certainly be an important question of equity jurisprudence, arising in an exclusively federal context and equally within this Court's certiorari jurisdiction. As has been said, "* * * foreign corporations, acts committed in other states, federal bankruptcy proceedings and federal tax rulings are scrambled in the legal situation * * *." (Jackson, J. in 345 U.S. 247 at 275, 276.)

Moreover, the court below has pitched its decision on a construction of the federal tax statutes, which it then carried to an extreme in its latest opinion, which respondent largely tries to ignore.

In an attempt to minimize the tax questions involved, respondent asserts that petitioner's views are contrary to those of the Treasury, the S.E.C., and other agencies (Br. pp. 12, 14, 18). The same claims were made in respondent's main brief in No. 150, last term, and were shown to be pretentious error in our brief in reply (at pp. 4 to 6).

The court below also supported its decision by invoking supposed requirements of federal railroad reorganization, by declaring itself helpless to decide otherwise because of alleged constitutional restraints on its power as a court, and by invading the field of fact finding, and its decision ignored the equities arising from a misuse of this Court's decision in *Ecker v. Western Pacific Railroad Corporation,* 318 U.S. 448. As to the latter, respondent, using the term "abuse of the decision" in the Ecker case even goes so far as to reply that such an abuse is "irrelevant" (p. 16).

II.

ON THE MERITS RESPONDENT RESTS ON ASSERTIONS CONTRARY TO ELEMENTARY PRINCIPLES

The second category of respondent's argument consists of Olympian assertions of propositions of fact and law so thoroughly exploded that we had thought they had been abandoned. Thus it says that petitioner "lost nothing" (Br. 18), that it had no income and therefore its loss had no tax utility to it (Br. 9), that petitioner had "nothing to sell" (Br. 16), that its claim is a demand for "tribute" (Br. 18), an exaction of "nuisance value" (Br. 17). But the usability of the loss as an offset for tax purposes gave it value; the fact that the market for it was restricted detracted nothing from its value to one in a position to utilize it; and there is no obligation to give to another a legal opportunity or avdantage just because its owner may not be able to utilize it himself. To refuse to give a gratuity may not be stigmatized as capitalizing mere

nuisance value. It does not constitute a blackmailing transaction which offers to forego doing another injury if bought off.* These principles are covered in our main brief in No. 150, Oct. Term 1952. (And cf. Jackson, J. in 345 U.S. 247 at 276, 277, where they are taken to be elementary).

Respondent's basic position is also reflected in its response to our statement that the tax result was accomplished by its taking over and managing petitioner's affairs for its own benefit. It vigorously asserts that its domination of petitioner and the existence of a fiduciary obligation to petitioner, and the like, are not "important"; it stands bluntly on the proposition that it "makes no real difference how or by whom the tax transactions were handled" (Br. 18), on the theory that petitioner lost nothing to which it was entitled. This, of course, is the doctrine laid down by the court below, and we submit that it alone calls for review by this Court.

While respondent also denies that it achieved the tax result by dominating and using petitioner's officers, in support of the denial it cites statements in the opinion of the court below. This is an effort to turn a vice into a virtue, for these are the statements we point to as constituting an improper invasion of the fact finding function. Respondent even asserts, disingenuously, that "The District Court reached the same conclusion" (Br. p. 4). On the precise question, the District Court said explicitly that the preponderance of the evidence supported petitioner's contention of domination and control by respondent, and it affirmed that "there is no question" that respondent conducted the tax proceedings and achieved the tax result through control of petitioner (see our Petition for Certiorari, pp. 35, 36).

There are references to alleged "past practice" (Br. pp. 4, 8, 20), a spurious argument for reasons noted in our petition in No. 150, last term (p. 20 of the appendix to our present petition for

*Respondent even asserts that "The Corporation did nothing to bring about the tax result except to provide a signature" (Br. 20). But the tax savings resulted from the conjunction of two elements: (1) joinder by petitioner in consolidated returns, and (2) the use therein of something belonging to petitioner, its loss.

certiorari). There are assertions about "unpaid creditors," not in reply to, but in disregard of, what we said at pages 19-22 of the present petition. If the one former creditor of respondent who was not paid in full (other than petitioner) were to receive from the tax savings enough to make up the difference, there would still be left $13,705,839 plus interest.

Finally, respondent depreciates the intervening stockholders (petitioners in No. 463), calling them speculators. But the Corporation itself, petitioner here, represents over 4700 stockholders (R. 659), the bulk of whom have owned their shares for years, being the very people who put up the $75 million that built the defendant railroad. They should not be denied their rights nor should a windfall be bestowed upon stockholders in the respondent railroad, merely because of claims, founded or not, about the interveners. The issue is a false one, and the argument is but part of the smooth self-righteousness by which respondent seeks to escape its just obligation.

III.

THE CASE IS RIPE FOR FINAL DECISION

This case is now ripe for final decision by this Court. Respondents express solicitude for the Court in having to receive further argument, written and oral. But if certiorari is granted, petitioner will mainly rest on the briefs filed in No. 150 last year as supplemented by the present petition for certiorari herein. We stand ready to assist the Court by oral argument, but if the Court should prefer to rely primarily on the arguments made in December, 1952, although they were not heard by the present Chief Justice, it of course has the power to place the cause on an appropriate docket.

We submit that the judgment should be reversed. Upon reversal there is no need for the cause to be remanded for further proceedings in any court below to determine who should prevail. While the Court of Appeals has intruded on the fact finding function, the facts it purported to find are material only upon one of its theories

of the case, and that theory is unsound. On the basic principles and on facts found by the District Court and never questioned, petitioner should recover.

The only remaining question is how much. A decision for petitioner on the merits would leave open, as we anticipate, merely a mathematical computation in the light of the governing principles declared by the Court. Those principles are simple and our views can be presented in short compass, upon the granting of certiorari.

CONCLUSION

We respectfully submit that the petition for certiorari should be granted and the judgment reversed with directions to enter judgment for the petitioner.

Dated: San Francisco, California, December 1, 1953.

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Office - Supreme Court, U.S.
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HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. 463

MERLDITH H. METZGER, HENRY OTTENHEIMER and J. S. FARLEE & CO., INC., *Petitioners*,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD., *Respondents*.

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

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IN THE

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No. 463

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE & CO., INC.,

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vs.

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TIDEWATER SOUTHERN RAILWAY,
DEEP CREEK RAILROAD COMPANY,
THE WESTERN REALTY COMPANY,
THE STANDARD REALTY AND DEVELOPMENT COMPANY and
DELTA FINANCE CO., LTD.,

Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

1. By its previous grant of certiorari on all issues without qualifications, this Court plainly held the merits as worthy of review as the en banc question. Respondents strain to divest this holding of its clear significance. According to respondents (Br. 11), this Court reversed itself when, in its previous decision, it failed to reach the substantive issues; "apparently", say respondents, the Court thought the merits deserved no consideration.

This far-fetched inference is belied, however, both by what this Court did and what it said. The majority of the Court did not reach the merits because it remanded the case for the procedural reason that the Court below, by not

properly entertaining the petitions for rehearing en banc, had failed to exhaust its appellate functions; hence the merits were not yet ripe for decision by this Court. The dissenting Justice, who saw no need for a remand, necessarily turned to the substantive issues and, having considered them, voted for reversal. This he could do because, as the majority opinion carefully stated, the en banc question was to be reviewed only "among other things" (345 U. S., at 250). The review on the merits is certainly no less appropriate now than when this Court granted it last year.

2. Respondents' contention that a second grant of certiorari under these circumstances would be "unprecedented" is simply wrong. Thus in the recent *Spector Motor* cases, this Court initially granted certiorari to review the constitutional validity of a state statute which the Court of Appeals had sustained. After full briefs and arguments, this Court, without reaching the merits of the constitutional question, remanded for the procedural reason that the scope of the statute should first be determined by the state courts; *Spector Motor Service* v. *McLaughlin,* 323 U. S. 101 (1944). After that determination was made, this Court again granted certiorari and settled the constitutional issues on the merits; *Spector Motor Service* v. *O'Connor,* 340 U. S. 602 (1951). The analogy of these proceedings to those at bar needs no elaboration. See also the repeated grant of certiorari, on the same record, in *S. E. C.* v. *Chenery Corp.,* 318 U. S. 80 (1943), and 332 U. S. 194 (1947).

3. The other grounds urged by respondents against allowance of the writ are equally unpersuasive.* While the facts of this case may be "unique", the principles of law on which it was decided below are broad and of far-reach-

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* We pass over respondents' wishful assertion (Br. 18, 19) that "no one denies" a series of suggested arguments which actually have been fully rebutted (our reply brief, pp. 8-19, in No. 160, last term).

We also pass over the vast liberties which respondents (Br., 4-6 et passim) take with the facts of this case, except to note that not

ing importance. Thus the Court below held, in effect, that *every* corporation with a tax loss is *required* to join in consolidated returns with its profitable affiliate in order to minimize the latter's taxes. Although respondents profess to find no such ruling in the decision below, the language of the Court is clear:

> "Under this state of facts [i.e., the parent having a tax loss, the subsidiary a taxable profit, and both having common officers] these officers had a positive duty to make use of the loss as they did, that is, to offset the income of members of the affiliated group with deductible losses of other members. If the positions of the corporations were reversed and the subsidiary had a loss and the parent had income, the officers would have been obliged to file consolidated returns to enable Corporation to make use of the loss." (R. 2233)

The breadth of this and similar holdings (see R. 2234, 2369) is such as to reach practically every group of affiliated corporations in this country and totally to subvert the statutory principle that the filing of consolidated returns is a privilege, but not a duty; *Duke Power Co.* v. *Commissioner*, 44 F. 2d 543, 545 (C. C. A. 4, 1930), cert. denied 282 U. S. 903. The New York case cited in our petition (p. 16) is but one outgrowth of the decision below; a rich harvest of similar litigations is bound to follow if that decision should remain unreviewed and unreversed.

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one of respondents' "fact" statements rests on findings of the trial court. Respondents' references are to "findings" of the Court of Appeals, to stray bits of testimony and to occasional remarks of the trial judge made during the trial. These references only serve to emphasize the necessity of proper findings of fact by the trial court in accordance with Rule 52(a) F. R. C. P.

Concerning, finally, respondents' personal attacks upon petitioners (Br. 9, 19), it is enough to say that they are based upon purported evidence which the trial court properly excluded. The irresponsible charge that petitioners purchased their shares "obviously for litigating purposes" (Br. 19), founders on the fact, demonstrated by respondents' own offered evidence, that petitioners became stockholders, respectively, in July, 1942 and in January and February, 1944 (R. 1905, 2102-3), long before the first of the consolidated returns here complained of was filed on July 15, 1944, and years before this litigation or its predecessors stockholders' action was instituted.

4. Also misleading is respondents' assertion (Br. 11-12) that the case turns only on state law principles of "unjust enrichment". Whether respondents' retention of all of the $17,000,000 benefit procured through the use of plaintiff's tax credit is "unjust" to plaintiff, depends on the federal question whether, as the Court below said, "the tax laws ordained" this advantage to fall to respondents (R. 2371) or whether, in the words of Mr. Justice Jackson, "the intention of the statute permitting the consolidation of the two positions was to provide salvage for the loser, not profit for one which sustained no loss."

5. There is, finally, no merit whatever to respondents' argument (Br. 12) that these tax questions should not be reviewed because the Treasury Department is not a party. The Treasury has no interest; the case does not involve its right to collect taxes. The case does involve the allocation between private parties of the burdens and benefits arising from the payment or non-payment of certain taxes. Just such an issue was presented in *Phillips-Jones Corp.* v. *Parmley,* 302 U. S. 233 (1937), discussed in our petition (p. 16). The absence of the Treasury in that case did not deter this Court from granting certiorari to do justice between the parties in accordance with the spirit of the tax laws. The present petitioners ask for no more than the same measure of justice.

Dated: December 3, 1953.

Respectfully submitted,

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HAROLD B. WILLEY, Clerk

In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 441

WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. duP. BAYARD, RECEIVER,
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Respondents.

Petition for Rehearing of Denial of Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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In the Supreme Court of the United States

OCTOBER TERM, 1953

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Respondents.

Petition for Rehearing of Denial of Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

On December 7, 1953 the Court denied a petition for writ of certiorari. Petitioner prays that this denial be reconsidered and that the petition for writ of certiorari be granted. This petition for rehearing is confined to one substantial ground available to petitioner but not previously presented in the petition for certiorari. Supreme Court Rule 33, subd. (2).*

*This new ground falls within the scope of some of the "questions presented" in the petition for certiorari, particularly question No. 1.

REASON FOR GRANTING THIS PETITION FOR REHEARING AND FOR GRANTING WRIT.

Involved in this case is the disposition of a trust fund of $3,385,290 deposited in the registry of the District Court by *petitioner* and awaiting disposition.

The case presents the following situation not called to this Court's attention in the petition for certiorari:

On a claim for refund filed in the name of a former parent corporation to recover taxes paid under a consolidated return, seeking to apply certain tax credits of the parent, the United States Government makes payment of a refund and does so to the one and only party whom it can recognize under the federal tax laws and regulations, viz., the parent, petitioner here. Then in a suit brought by the former parent against a former subsidiary, the parent deposits the sum in a United States District Court as part of its application for instructions, and that court not only denies the parent a right to an accounting of certain other tax savings, which are in the possession of the subsidiary, *but it also compels the parent, who had received the tax refund from the Government, to pay that money to the former subsidiary,* the respondent. The Court of Appeals sustains this command under the view that the tax laws of the United States so require.

The petition for certiorari addressed itself to the denial of relief to petitioner with respect to the tax savings in respondent's possession. The ground now presented relates to an order which compels petitioner to pay to respondent a sum of money which the Government paid to petitioner and under no circumstances would or could have paid to respondent.

The facts under which this situation arises are briefly these.

The total tax savings in this case, amounting to $21 million, in round figures, arose in *two* ways. (1) Respondent paid no tax for the years 1943 and 1944, the returns reporting none due by virtue of petitioner's loss. This accounted for roughly $17 million. (2) A tax of roughly $4 million had been paid for 1942 (R. 266). Then in March 1945, nearly one year after affiliation between petitioner and respondent had ceased (not only actually but also

technically), and 2½ months after respondent was out of the hands of the Reorganization Trustees, a claim for refund was filed with the Treasury to recover this sum (R. 266, 1656). The foundation of the claim was the use, as a carry-back, of an unused portion of petitioner's same loss. This claim for refund was filed *in petitioner's name*, not respondent's (R. 1654). It *had* to be so filed, because under the federal tax laws and regulations a claim for refund of taxes paid under a consolidated return can be made only by the parent and may not be made by the subsidiary. Similarly, where a refund is granted, it is paid to the parent, it may be paid to no one else, and the Government recognizes only the parent. Treasury Regulation 104, Section 23.16a provided, *inter alia*, that

> "refunds must be made directly to and in the name of the common parent and will discharge any liability of the Government in respect thereof to any such [i.e., affiliated] corporation."

This suit was instituted in October 1946, ten months before the tax controversy was settled with the Government. The complaint asked for an accounting of the tax savings in respondent's possession and also tendered to the court, for adjudication, any moneys petitioner might thereafter receive from the Government on the claim for refund (R. 10). Respondent counterclaimed for a prohibitory injunction enjoining petitioner from receiving for itself any moneys it might get under the claim of refund and for a mandatory injunction commanding petitioner to endorse and to deliver to respondent all checks it should receive from the U. S. Treasury and for an order quieting title in respondent to any refund (R. 34, 35).

Thereafter respondent's tax counsel proposed to the Government a settlement whereby the claim for refund would be waived and the returns for 1943 and 1944 would be accepted as filed, showing no tax due (R. 1662). Since the Government recognizes only the parent, respondent's counsel had to obtain a power of attorney from petitioner to affirm the offer in its name. He pre-

pared and obtained such a power from petitioner's president, Curry, who signed it without consulting his Board of Directors, because respondent's counsel told him that he wanted it (R. 1784, 668).

In April 1947 respondent's counsel first requested petitioner's approval of the offer of settlement, and thereby petitioner's board learned of the power of attorney (R. 1787, 1788). The board replied by letter, saying (R. 1796):

> "Inasmuch as in the proposed settlement the Railroad Corporation [petitioner] foregoes *its* refund claim of $4,200,000, we think it appropriate that a stipulation promptly be entered into between the Railroad Company [respondent] and the Railroad Corporation, and the other members of the Group, which will insure the Corporation its day in court for a settlement of the questions of proper and equitable allocations of tax savings, if any, as well as fixing the amount of the refund as the basis for such savings."

Petitioner and respondent thereupon negotiated for a stipulation as a condition to approval by petitioner of the settlement offer. A stipulation was prepared. But at that point certain intervening stockholders of petitioner (petitioners in No. 463 herein) applied to the District Court in this case for an order enjoining the parties from settling the tax controversy with the Government on the proposed basis (R. 335). There was no objection to a settlement whereby the tax savings would be $17 million instead of $21 million. But a refund, if paid, would come to petitioner as the only party to whom the Government would or could make the payment, whereas the form of the proposed settlement was such that it waived the refund and left respondent in possession of all the tax savings, instead of diminishing all elements of the claimed savings by 4/21sts. The fact of possession might become crucial.

After discussion in open court on August 25 and 26, 1947, on the application for the injunction (R. 335-399), it was made clear that the proposed stipulation was intended to mean that the tax settlement with the Government should be regarded as one not abandoning the refund claim but as allowing and paying it

proportionately, and it was agreed that it should be so construed (R. 390). The court made *its formal pre-trial order* that it should be so regarded, and on that condition it denied the restraining order (R. 163), and the stipulation was executed and filed (R. 168). The order provided that the court shall "determine the issues and give judgment herein, in the same manner as if said tax savings had been allowed and said refund claim allowed and paid by the United States Government in the ordinary course and manner prescribed by law and as proportionately reduced by said settlement" (R. 166).

In reliance on this stipulation and pre-trial order which established the predicate on which the case was to proceed, the tax settlement was allowed to occur. The effect of the pre-trial order and stipulation was to regard respondent as having paid to the U. S. Treasury 4/21sts of $17 million as taxes due and owing for 1943-44 and to treat 17/21sts of the $4 million involved in the claim of refund—to be exact, the sum of $3,385,290—as having been paid by the Government *to the petitioner* and by it paid into court to await judgment.

This matter was briefly covered in the dissenting opinion of Judge Fee in the Court below:

> "The stipulation of the parties was that a fund was paid into Court by plaintiff and therefore it must be returned to plaintiff's possession, unless some affirmative proof showed defendant was entitled thereto. * * * the Trial Court affirmatively awarded this to defendant. But no findings to sustain affirmative award are present." (Fn. 19, R. 2253).

Further (R. 2246):

> "By the stipulation, plaintiff 'as agent' was trustee of an express trust and, as such, had a right to deposit the fund and ask for a determination of the rights of all parties thereto, as in the nature of interpleader. Plaintiff affirmatively demanded findings upon this feature, and the Trial Judge refused to make them. [*] A stipulation of parties to litigation that a

*See R. 439-444. This footnote added by us.

fund is deposited in court is sufficient. The Court must give affirmative directions that the fund be paid to the proper party.[20] Before such a judgment be entered, findings of fact are required. It is assigned as error that the Trial Judge refused to make findings on this point. The rule requires findings of fact. This is error requiring reversal. The judgment here against plaintiff did not end the case. According to the very record before us, there is still a fund in the Trial Court which has not been distributed.

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[20]Rule 67, Federal Rules of Civil Procedure; 28 U.S.C.A., Secs. 2041, 2042; Georgia vs. Madrazo, 26 U.S. 110, 121; United States vs. Morgan, 307 U.S. 183, 193; Osborn vs. United States, 91 U.S. 474, 479." [This footnote is part of the opinion, appearing at R. 2253]

CONCLUSION

There are literally thousands of consolidated returns filed each year, and refunds are paid by the Government to the parent corporation thereunder. The decision below will throw intercorporate accounting into confusion.

We respectfully submit that the petition for rehearing should be granted.

Dated: San Francisco, California
December 17, 1953.

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I hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay and that it is restricted to grounds specified in Rule 33 of the Rules of this Court.

December 17, 1953.

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In the Supreme Court of the United States

OCTOBER TERM, 1953

THE WESTERN PACIFIC RAILROAD CORPORATION and ALLEN L. DU P. BAYARD, Receiver,
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THE WESTERN PACIFIC RAILROAD COMPANY, et al.,
Respondents.

No. 441

Respondents' Response to Petition for Rehearing of Denial of Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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No. 441

Respondents' Response to Petition for Rehearing of Denial of Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

The petition for rehearing does not, for many reasons, justify or require a grant of certiorari which the Court has already denied.

First. The petition is not within the purpose or intent of Rule 33(2). It seeks to bring forward not a new ground in support of the petition for certiorari, but a new question for consideration by the Court, a question which the petition for certiorari does not present. See "Questions Presented," pages 2 and 3 of the petition for certiorari and compare the petitioners' statement of "points on which they intend to rely" in the Court of Appeals (R. 2168-72, particularly point 9, R. 2170). The Court will not consider questions other than those presented in the petition.

United States v. Penn Mfg. Co., 337 U.S. 198, 205, n. 1;

Nat'l Licorice Co. v. Labor Board, 309 U.S. 350, 357, n. 2;

General Talking Pictures Co. v. Western Electric Co., 304 U.S. 175, 177;

Washington Coach Co. v. Labor Board, 301 U.S. 142, 146.

Second. The petition raises no question of federal law, it does not suggest a conflict with a decision of another Court of Appeals, nor is it directed to a matter of any public importance (Rule 38(5)). The meaning and effect of a particular stipulation in a particular case is hardly a matter with which this Court should concern itself. The Court has said repeatedly that it will not on certiorari consider matters of interest only to the parties. See, for instance, *N.L.R.B. v. Pittsburgh Steamship Co.*, 340 U.S. 498, 502.

Third. There is nothing left undone or undisposed of by the courts below. By express provision of the stipulation (R. 169) no money was actually paid into court and the judgment of the District Court (R. 324), affirmed on appeal (R. 2255), fully disposes of the litigation.

Fourth. The argument petitioner seeks to present here was presented in both courts below and by both rejected. See the record in the trial court (R. 277-83, 319, 419, 429-32, 453) and the opinion of the Court of Appeals (R. 2214, 2235-7), particularly the following excerpt:

> "The stipulation and pre-trial order were entered into and made for the purpose of protecting the position of Corporation in relation to the refund claims *only* if it should be found entitled to the refund. *The court found*

it was not entitled to it. Appellants' position is no stronger with respect to the refund for 1942 taxes paid by the subsidiaries than it is with respect to the 1943 and 1944 savings of the subsidiaries." (R. 2237; emphasis as reported at 197 F.2d 1006)

This seems plainly correct—which perhaps accounts for the fact that petitioners did not see fit to advance their present contention in seeking a rehearing in the Court of Appeals or when the case was before this Court last term.

The petition for rehearing should be denied.

Dated: December 23, 1953.

Respectfully submitted,

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